June 1964

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A Comparison of the Drawee's Rights on Altered Instruments Under the Common Law, NIL and UCC

WILLIAM O. MORRIS*

Prior to the adoption of the Uniform Negotiable Instruments Act, hereafter referred to as the NIL, courts in the various jurisdictions in the United States consistently held that the doctrine of the case of Price v. Neal1 should not be extended to cover checks which had been altered after execution and prior to payment by the drawee bank. That well known case, decided over two centuries ago, was concerned with the issue of whether the drawee which had paid two instruments, one having been previously accepted, might recover back from the party who had received payment on the bills upon discovering that the drawer's signature on the instruments had been forged. The English court refused to permit recovery back by the drawee-payor the sum paid on these forged instruments. This case is frequently cited as authority for the proposition that the drawee who has paid a good faith purchaser of a bill on which the drawer's signature had been forged is not entitled to recover back from the recipient of payment the sum paid on a forged bill. While there might well have been, and probably was, a mutual mistake of fact in paying and receiving payment on the forged bills, the drawee was nevertheless charged with the responsibility of recognizing the forgery of the drawer's signature at the time the drawee accepted or paid the instrument. The drawee having admitted by paying or accepting the instrument the genuineness of the drawer's signature at the time of accepting or paying the bill such drawee is thereafter estopped from raising the issue of the lack of genuineness of the drawer's signature against one who received payment in good faith and had acquired the instrument for value.

If the drawee is estopped after paying or accepting a bill from questioning the genuineness of the drawer's signature, should he likewise be estopped from subsequently raising the issue of whether the instrument had been altered after execution such as by changing the name of the payee or raising the amount of the instrument? The

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1 3 Burr. 1354 (K. B. 1762).
common law, as it will subsequently be developed, permitted the drawee who had paid an altered instrument to recover back the money paid from the party with whom the drawee had dealt on the theory of money paid under mistake of fact.

In one sense an altered bill is a forged bill for clearly the altered instrument is not the drawer's order, for the drawer gave one order and the instrument purports to carry another order. However, prior to the adoption of the NIL the courts applied the doctrine of money paid under mistake of fact in order to permit the drawee-payor to recover back the money improperly paid on an altered bill when the drawee had not been negligent in making payment, while denying the drawee the same right when the drawer's signature had been forged.

**Measure of Recovery**

It is elementary that the drawee may only debit the account of the drawer when the drawee paid in strict compliance with the order given by the drawer. If after execution of the bill the name of the payee is changed the drawee upon payment of the bill may not debit the account of the drawer for the drawee had not paid the instrument in accordance with the drawer's order. In this instance the drawee-payor may recover back the entire amount paid on the instrument from the person to whom payment was made.

Where the alteration is only to the amount of the bill the drawee might debit the account of the drawer according to the original tenor of the bill or check. The only portion of the payment which was paid under mistake of fact was the excess over the amount of the original tenor of the bill or check and the drawee would be limited to recovering only this amount from the one to whom payment was made.

In instances where the bill or check was altered as to both payee and amount the drawee not having paid anything in accordance with the drawer's order, if entitled to any recovery, could recover back the entire sum paid from the recipient of payment.

**Common Law**

In the leading case of *Espy v. First Nat'l Bank* the S. & M. depositors in the First National Bank made a check payable to the

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\(^2\) 85 U. S. (18 Wall.) 947 (1873).
order of E. Hart in the amount of $26.50. A stranger to the instrument erased the name of the payee and the amount and inserted as the payee the name of Espy, Heidelback & Co. and the amount of $3,920 dollars and passed it for value to the named payee. Shortly after the drawee paid the check the alterations were discovered and the drawee demanded a return of the sum paid. Justice Miller speaking for the court said: "The principle that money so paid under a mistake of fact of the case can be recovered back is well settled, and in the case of raised or altered checks so paid by banks in which they were drawn. There are numerous well-settled cases where the right to recover has been established, when neither party receiving nor the party paying has been in any fault or blame in the matter."  

One might consider whether the drawee should be put on notice of the fact that a check had been altered merely because the handwriting in the body of the check is different from that of the drawer's signature. The California court in an action to determine upon whom the loss should fall in respect to a check which had been altered as to date, name of the payee and amount indicated in dicta that the drawee bank which cashed the check in good faith and without negligence could recover from the party receiving payment the amount over and above the original tenor of the instrument on the theory of money paid under mistake of fact. The fact that the body of the instrument was in a different handwriting than the signature of the drawer would not in law or in the ordinary course of business cause one paying the instrument to be suspicious since checks are often filled in by persons other than the party signing.

Two years after the decision in the California case, the Missouri court in the case of *Third Nat'l Bank v. Allen* involved a check which had been altered as to amount and as to the payee prior to payment by the drawee bank. The Missouri court permitted the drawee bank to recover back the amount paid by the drawee bank. As the plaintiff had in no way contributed to the mistake the plaintiff was permitted to recover back the money paid under mistake of fact. The recovery returned the parties to the position held by each prior to the operation of the mistake. Just months after the *Third

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3 Id. at 949.
5 59 Mo. 310 (1875).
National Bank case was decided the New York court reached the same result in White v. Continental Nat'l Bank.\textsuperscript{6}

Shortly thereafter the Texas court in City Bank v. First Nat'l Bank\textsuperscript{7} permitted the drawee that had paid a check which had been altered as to amount to recover from the party with whom the bank had dealt the difference between the original tenor of the check and the sum paid. Again the decision was based on the theory of money being paid under mistake of fact. The court indicated that the bank would be entitled to the recovery even if the paying bank had been negligent in making payment so long as the recipient of the payment was not damaged by that negligence.

What is the effect of an indorsement so far as establishing liability? Prior to the adoption of the NIL some few courts permitted the drawee bank which had paid a check to recover from an indorser, who endorsed subsequent to the alteration, for breach of warranty. In Farmers Bank v. Bank of Abbeville,\textsuperscript{8} decided a year prior to the adoption of the NIL by the Georgia legislature, the court in its syllabus to the case stated: "Every transferee of a negotiable instrument, warrants (unless otherwise agreed by the parties) that he is the lawful holder and has a right to sell, that the instrument is genuine, and that he has no knowledge of any fact which proves the instrument to be worthless, either by insolvency of the maker, payment, or otherwise."\textsuperscript{9} In this opinion, which leaves something to be desired, the court, without giving any consideration to whom the warranties extended, stated simply: "It [the drawee] had the right to proceed upon the indorsement; and this right could not be defeated upon the ground that it might have proceeded against the drawer."\textsuperscript{10}

In the prior considered City Bank case\textsuperscript{11} the Texas court permitted the drawee to recover back the difference between the original and altered tenor of the check on the theory that the defendant's indorsement thereon was a representation and warranty that "The indorsement . . . by the defendant amounts to a representation and warranty that it was genuine."\textsuperscript{12}

\textsuperscript{6} 64 N.Y. 316 (1876).
\textsuperscript{7} 45 Tex. 203 (1876).
\textsuperscript{8} 29 Ga. App. 472, 116 S.E. 204 (1923).
\textsuperscript{9} Id. at 472, 116 S.E. at 205.
\textsuperscript{10} Id. at 475, 116 S.E. at 206.
\textsuperscript{11} 45 Tex. 203 (1876).
\textsuperscript{12} Id. at 217.
The plaintiff might well rely on this responsibility of defendant, and make payment when demanded, secure in being reimbursed if the amount of check should prove to have been raised.

The language used by the New York Court in White v. Continental Nat'l Bank\textsuperscript{13} is most interesting. In that case the court reversed the decision of the lower court which had found for the defendant in which the drawee had sought to recover back the sum paid on an altered check. The court summarized the applicable principles in the following concise language: "The plaintiffs, as drawees of the bill, were only held to a knowledge of the signature of their correspondents, the drawers; by accepting and paying the bill they only vouched for the genuineness of such signatures, and were not held to a knowledge of the want of genuineness of any other part of the instrument, or of any other names appearing thereon, or of the title of the holder."\textsuperscript{14} Judge Allen speaking for the court continued by starting: "The defendant a holder of the bill and claiming to be entitled to receive the amount thereof from the drawees, was held to a knowledge of its own title and the genuineness of the indorsements, and of every part of the bill other than the signature of the drawers, within the general principle which makes every party to a promissory note or bill of exchange a guarantor of the genuineness of every preceding indorsement, and of the genuineness of the instrument."\textsuperscript{15} The court in effect stated that the presentation of the check for payment and the receipt of payment by the defendant was equivalent to an indorsement by the defendant and he should be held liable accordingly.

While in Redington v. Woods the California\textsuperscript{16} court denied the drawee the right to recover any sum paid on an altered check because the drawee had failed to return or offer to return the altered check to the defendant, the court by way of dicta stated: "But in view of another trial, it may be proper to notice the proposition urged by plaintiff, to the effect that by indorsing the check the defendants guaranteed that it was genuine in respect to the amount appearing on its face."\textsuperscript{17} In respect to the effect of the indorsement of the recipient of payment the court stated that the indorsement "implies, at best, only an undertaking that he has a valid title to the bill or

\textsuperscript{13} 64 N.W. 316 (1876).
\textsuperscript{14} Id. at 318.
\textsuperscript{15} Ibid.
\textsuperscript{16} 45 Cal. 406 (1873).
\textsuperscript{17} Id. at 428.
check, and consequently, a right to receive payment—an implication which the law raises without the indorsement. But the indorsement, *proprio vigore,* imposes upon him no other or greater liability to refund money paid upon an altered check than would attach to him without the indorsement.”

**DUTY AND RESPONSIBILITIES OF DRAWEE UPON DISCOVERING ALTERATION**

What is the responsibility of the drawee in respect to diligence in discovering and giving timely notice that the instrument which it had paid had been altered?

The English jurist, Justice Mathews, in setting forth the view of the English courts in respect to the drawee’s duty to promptly discover and act in regard to altered bills which the drawee had paid stated: “If the mistake is discovered at once, it may be the money can be recovered back; but if it be not, and the money is paid in good faith, and is received in good faith, and there is an interval of time in which the position of the holder may be altered, the principle seems to apply that money once paid cannot be recovered back. The rule is obviously, as it seems to me, indispensable for the conduct of business.”

An American court as early as 1840 had in the Louisiana case of *Merchants’ Bank v. Exchange Bank* concerned itself with the question of diligence on the part of the drawee in discovering the alteration of a bill. This case involved a check which had been altered in amount from $213.50 to $5,013.50, then indorsed and subsequently paid by the plaintiff. The plaintiff learned of the alteration on July 17, 1837 and informed the defendants of the alteration on August 2, 1837. The defendant unsuccessfully pleaded that the plaintiff had been guilty of laches in failing to give the defendant timely notice of the discovered alteration.

Later the Missouri appellate court was concerned with the almost identical issue which had concerned the Louisiana court in the *Merchants’ Bank* case. The Missouri case of *Third Nat'l Bank v. Allen* involved a check which had been altered in amount from...

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20 16 La. 457 (1840).
$20.00 to $36.38 prior to payment by the drawee-plaintiff. The plaintiff discovered the alteration the day after it had paid the check and, according to the plaintiff's testimony, the same day notified the defendant. The court in considering the length of time allowed to the drawee to give notice said: "... one who pays money on forged paper ... by cashing it, can always recover it back ... [if he] has given sufficient early notice of the mistake to the other after he had discovered it ... . In the early English cases it was strictly held that the payor could not recover the money unless he gave notice on the very day of the payment and before any change of circumstances." The court continued by stating: "The American courts have mostly repudiated it, and the accepted rule is that the payor must be allowed a reasonable time to detect the forgery and demand restitution. ... Therefore where no negligence is imputable to the drawee in failing to detect the forgery, want of notice within the time which ordinarily charges previous parties on negotiable paper is excused, provided it be given to the holder as soon as the forgery is discovered." The New York court in White v. Continental Nat'l Bank stated the right of the drawee who had paid an altered instrument to have recovery back is unquestionable "unless their right is barred by some circumstance which takes the case out of the general rule, or by some act of their own they have lost the right." Here there was not such a change in position on the part of the defendant to create an estoppel against the plaintiff in his effort to recover against the defendant. The New York Court expressed its view through the following statement: "It is now settled both in England and in this state that money paid under a mistake of fact may be recovered back, however negligent the party paying may have been in making the mistake, unless the payment has caused such a change in the position of the other party that it would be unjust to require him to refund." The same conclusion was reached by the Texas court in City Bank v. First Nat'l Bank. The Texas court stated the law as follows: "The modern doctrine is believed to be that, as against one who

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22 Id. at 313.  
23 Ibid.  
24 64 N.Y. 316 (1876).  
25 Id. at 318.  
27 45 Tex. 203 (1876).
passes a raised bill or check, and especially in form of a drawee who pays to such a party on the faith of his indorsement, and in so doing violated no obligation or duty, reasonable diligence is all that can be required, and where that is exercised, and no damage has resulted from the delay, the right to recover is not lost. The plaintiff was allowed recovery.

As evidenced by Redington v. Woods the drawee must return or offer to return the altered check to the defendant as a condition precedent to any right of recovery since the law will presume actual or potential damage from the plaintiff's failure to return the check. The defendant would need the instrument to proceed against prior persons liable on the instrument, the court reasoned.

RIGHTS OF DRAWEES AS AGAINST COLLECTING BANK

The question of the right of the drawee bank to recover from the collecting agent in instances where the drawee paid an altered check to one who held the instrument under a restrictive indorsement was the concern of the California court in Crocker-Woolworth Nat'l Bank v. Nevada Bank. The Bank of Woodland drew its check upon the Crocker Bank for twelve dollars to the order of Dean. Dean altered the check from twelve dollars to 22,000 dollars and indorsed it with a general indorsement and received "provisional credit" in the Nevada Bank which sent it through the usual clearing house procedure for collection. The check found its way in regular course from the clearing house to the Crocker Bank, which was the correspondent of the Woodland Bank (drawer) and had on deposit funds of the Woodland Bank. After payment had been made to the Nevada Bank, Dean checked out 20,000 dollars leaving but 2,000 dollars in his account in the Nevada Bank.

The California Supreme Court reversed the decision of the lower court which had been in favor of the plaintiff because of the clearing house rules which provided that negotiable paper deposited for clearance by members of the association should bear the stamp of the depositing bank, which stamp should be, "For clearing house purposes only," and should guarantee the validity and regularity of prior indorsements, and that every bank should file with every

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28 Id. at 219.
29 45 Cal. 406 (1873).
31 139 Cal. 564, 73 Pac. 456 (1903).
member a certified impression of its clearing house stamp. Held, that where a "raised" check payable to an individual and drawn on a bank was deposited by another bank with the clearing house indorsed by stamp, "Pay through clearing house," the indorsement conveyed no representation to the drawee that the depositing bank claimed itself to be the owner of the paper; and hence, in an action by the drawee which paid the check to recover from the other bank, it was permissible for it to show that it had acted merely as a collecting agent for the payee to whom it had paid the money.

The court states: "At and before the time of making payment the plaintiff had no notice or knowledge whatever that the defendant was not, as it purported and represented itself to be, the absolute owner and holder of said check, and no notice or knowledge that the said check was presented by the defendant as agent for collection only, or otherwise than as owner and principal."32 "The value and importance of this finding to support the judgment arises from the principle above stated, that if one be, or hold himself out as, the owner of such paper, then a recovery may be had against him, if it be reasonably sought, because he will be the holder of money paid, which in good conscience and equity he should not be allowed to retain; whereas, in the case of an agent, recourse is limited to the principal."33

The court also stated: "Still further, an implied warranty of genuineness accompanies the unrestricted indorsement and transfer of any negotiable instrument. It is an assurance to the drawee of its genuineness in all respects, saving that of the name of the drawer alone, with which knowledge of the drawee is charged."34 While the court earlier in the opinion had referred to money paid under mistake of fact, this statement by the court would lead one to believe that the court based its decision in part on the fact that the defendant had indorsed the instrument.

Judge Vance in National Park Bank v. Seaboard Bank35 was of the opinion that if a draft is paid by the drawee under a mistake of fact, that is, that the defendant either owned it, or simply held it for collection as an agent, the drawee-payor could obtain restitution from the one who received payment provided its condition had not

32 Id. at 577, 73 Pac. at 460.
33 Id. at 577, 73 Pac. at 460.
34 Id. at 574, 73 Pac. at 459.
35 114 N.Y. 28, 20 N.E. 632 (1889).
in the meantime changed so that it would be unjust or in case of agency the agent had not paid the money over to the principal, as where the one who received payment was not the owner of the bill but merely presented it for payment as the agent of another. The agent could not be required to repay if the agent had paid over to its principal the sum received before receiving notice of the mistaken payment. The plaintiff in National Park Bank v. Seaboard Bank26 claimed that the entry, made by the defendant who had received the bill for collection, on its books to the credit of Eldred Bank, which had received the check for collection upon receipt of the draft proved that it belonged to the defendant, while the defendant claimed that the restrictive indorsement of the draft by Eldred bank prevented any change of title, and simply evidenced an agency for collection. As settlement had been made by one deemed an agent to collect with his principal before the alteration was discovered, the drawee could not recover back from the collecting agent any portion of the sum paid. All sums to the credit of the Eldred Bank at the time of payment had been paid by defendant to the Eldred Bank before the alteration was discovered. The defendant was held not liable to plaintiff for the amount thus erroneously paid to it.

In a subsequent case37 involving this same transaction, but between the National Park Bank and Eldred Bank, the drawee, National Park Bank, was permitted to recover from Eldred Bank the sum erroneously paid. The court stated:

"In the case at bar the draft was indorsed absolutely to the Eldred Bank, and they directed its collection for their own account, thereby assuming the place of principal as far as the plaintiff was concerned. If they were acting as collecting agents only, as they now claim, such agency was not disclosed to the plaintiff at the time of the transaction, and it had the right to rely upon the responsibility of the defendant, as owner of the draft, in payment of the same."38

In United States Nat'l Bank v. National Park Bank,39 it was held that in order to absolve the collecting bank from liability to the drawee

26 Ibid.  
37 35 N.Y.S. 752 (Sup. Ct. 1895); aff' 154 N.Y. 769, 49 N.E. 1101 (1897).  
38 Id. at 754.  
39 13 N.Y.S. 411 (Sup. Ct. 1891); affirmed in 129 N.Y. 647, 29 N.E. 1028 (1891).
on an altered check the agent must have actually parted with the money and have paid over the proceeds to its principal. In this case there had been no transfer of funds but credit had been given and the credit had never been drawn against. The drawee was permitted recovery.

THE RIGHTS OF THE DRAWEE UNDER THE NIL

Section 62 of the NIL provides: "The acceptor by accepting the instrument engages that he will pay it according to the tenor of his acceptance . . . ." Because of the language used in this section of the NIL the question immediately presented is: Whether a bank which certified a check which had been altered is liable to the holder of the certified check according to the original tenor of the instrument or for the amount of the instrument as altered, and secondly whether payment, as to instruments not previously accepted, is in fact an acceptance of the instrument within the meaning of the term as used in this section?

Dean James Bar Ames stated in the Harvard Law Review:

"Since an acceptor, by section 62, engages to pay the bill 'according to the tenor of his acceptance,' he must pay to the innocent payee or subsequent holder the amount called for by the bill at the time he accepted, even though larger than the original amount ordered by the drawer. . . . If the acceptor or certifying bank must honor his acceptance or certification in such a case, a fortiori a drawee who pays a raised bill or check, without acceptance or certification should not recover the money paid from an innocent holder."

Thus it may be seen that Dean Ames was of the opinion that the doctrine of Price v. Neal was by section sixty-two of the NIL made applicable to instruments which had been altered after execution and that the drawee who paid an innocent holder of an altered instrument would not be entitled to recover back the sum paid on the instrument as was permitted at common law.

In Interstate Trust Co. v. United States Nat'l Bank the Colorado court was concerned principally with whether an indorsement "Pay to the order of any bank or banker—previous indorsements guaranteed" was or was not a restrictive indorsement. The court did cite

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with approval the case of Espy v. First Nat'l Bank\textsuperscript{42} and Bank of Commerce v. Union Bank\textsuperscript{43} to the effect that the drawee who pays an altered check may recover back the sum paid. In the Interstate Trust Co. case the payee's name had been altered. The bank could not rightfully debit the account of the drawer, for the drawee had not paid the instrument in accordance with the drawer's order. The drawee could rightfully recover the sum paid from the party to whom the bank had made payment. Part of the language used in this case by the Colorado court was subsequently overruled by the Colorado court in 1954 in the case of American Nat'l Bank v. First Nat'l Bank.\textsuperscript{44} The portion of the opinion which the court disavowed would not in any way affect the result of the prior case.

The Supreme Court of Missouri in the case of McClendon v. Bank of Advance,\textsuperscript{45} which was decided after the NIL had been adopted in Missouri, reversed the decision of the lower court without comment as to the effect of the NIL in respect to the rights of the drawee who has paid checks which have been forged as to drawer's signature or altered. The court, in reversing and remanding, stated that the payment had been made as the result of a mistake. The drawee proceeded on the theory the money had been paid under mistake of fact. The court did not consider any question of liability on the theory of breach of warranty.

Five years after the decision in the McClendon case the Missouri Appellate Court was faced again with the same basic problem in the case of Central Nat'l Bank v. F. W. Drosten Jewelry Co.\textsuperscript{46} The facts in the latter case disclosed that the check had been altered as to payee and amount prior to its use by the holder to purchase a cashier's check, after first inquiring of the drawee-bank if the check was good. The Appellate Court reversed the lower court and allowed plaintiff-drawee to recover the sum which had been paid on the check. The court also stated that the complaining-drawee could recover without having returned the check, or having made demand for payment by defendant prior to the institution of the suit.

In at least three cases from three different jurisdictions decided after the adoption of the NIL it has been held that the drawee who

\textsuperscript{41} 67 Colo. 6, 185 Pac. 260 (1919).
\textsuperscript{42} 85 U.S. (18 Wall.) 947 (1874).
\textsuperscript{43} 3 N.Y. 230 (1850).
\textsuperscript{44} 130 Colo. 557, 277 P.2d 951 (1954).
\textsuperscript{45} 188 Mo. App. 417, 174 S.W. 203 (1915).
\textsuperscript{46} 203 Mo. App. 646, 220 S.W. 511 (1920).
had paid an altered bill could not recover back the money paid. In National City Bank v. Nat'l Bank, the drawee paid the possession of a check which had been stolen from the mails by Manning who erased the payee's name and inserted his own name. Manning tendered the check to a jeweler in payment of merchandise, and the bank, having certified the check, the merchandise was delivered to him. Upon discovering the alteration the drawee sought to recover the amount paid. The appellate court reversed the lower court and denied to the drawee the right to recover the sum paid on the altered instrument. The court noted that the defendant had taken the instrument in good faith, for value with no notice of any infirmity in the instrument or defect of title of the person negotiating, and was therefore a holder in due course. The court stated: "... Section 62 is in accordance with that sound principle which declares that where one of two innocent parties must suffer a loss the law will leave the loss where it finds it." The court did recognize that in two cases decided in the same jurisdiction prior to the adoption of the NIL, the drawee-payor had been permitted to recover back money paid on the theory that the money had been paid by the drawee-payor under mistake of fact and that First Nat'l Bank v. Northwestern Nat'l Bank, in so far as the principles announced in these decisions were in conflict with the NIL they were overruled. In both of these older cases the court specifically held that the acceptor of the draft did not warrant the genuineness of the body of a draft either as to the payee or as to amount.

Twenty years after the decision in the National City Bank case the California Supreme Court in the case of Wells Fargo Bank & Union Trust Co. v. Bank of Italy was called upon to determine whether the drawee bank which had certified and paid a check on which the payee's name had been previously changed could recover back the payment which it had made on the altered check. The defendant qualified as a holder in due course of the check. The sole question for determination was whether the acceptor is liable as an acceptor according to the tenor of the instrument as originally drawn or as to its tenor at the time of acceptance. The court noted that the majority of the decisions at common law permitted a bank which had certified a check after it had been fraudulently altered, as to

47 300 Ill. 103, 132 N.E. 832 (1921).
48 Id. at 108, 132 N.E. 833.
49 152 Ill. 296, 38 N.E. 736 (1894).
50 214 Cal. 156, 4 P.2d. 781 (1931).
the amount or the name of the payee, and afterwards paid, all other things being equal, to recover back even against one who had been a bona fide purchaser.\footnote{51} The same rule was followed in New York in National Reserve Bank v. Corn Exchange Bank\footnote{52} after the NIL. The California Supreme Court affirmed the decision of the lower court and denied to the drawee accepting bank the right to recover back the sum paid on the altered check. The presentation of a check and the surrender of possession of a check to the drawee for payment is not a negotiation of the instrument within the meaning of the term as used in the NIL, therefore the recipient of payment is not liable as a warrantor under section 66 of the NIL. The drawee who pays a bill or check does not become a holder in due course of the instrument under section 52 of the NIL, nor even a holder of the instrument by the terms of section 191 of the NIL. The drawee that pays a bill or check is not recognized as a transferee of the title to the instrument because by drawee's payment the drawee converts what was formerly a check or bill into a voucher.\footnote{53} At common law the liability on the part of the party receiving payment on an instrument which had been altered rested upon his quasi contractual duty to return money received under mistake of fact and not upon any theory of breach of warranty. The section to recover would not be found upon the instrument itself for it had been paid. The conclusion of this case is in harmony with the law of England and continental countries.\footnote{54}

The most recent important case involving the effect of section 62 of the NIL as to instruments which had been altered is Kansas Banker's Surety Co. v. Ford County State Bank,\footnote{55} decided by the Supreme Court of Kansas in 1959. In this case the action was by the insurer-subrogee of the drawee-payor bank which had paid an

\footnote{51}Esdy v. First Nat'l Bank, 85 U.S. (18 Wall.) 947 (1874); Metropolitan Nat'l Bank, 182 Ill. 367, 55 N.E. 360 (1899); Park v. Roser, 67 Ind. 500 (1879); Bank of Commerce v. Union Bank, 3 N.Y. 230 (1850); Marine Nat'l Bank v. National City Bank, 59 N.Y. 67 (1874); White v. Continental Nat'l Bank, 64 N.Y. 316 (1876); City Bank v. First Nat'l Bank, 45 Tex. 203 (1876).


altered check. The defendant was treated by the court as having been a holder in due course of the check. The issue in this case was clearly set forth in the following unambiguous terms: "The sole question presented is whether the drawee bank is liable on its payment to the indorsee bank according to the tenor of the instrument as originally drawn or according to the tenor of the instrument at the time of its payment." The check in question as originally drawn by D. W. Burnet was dated November 20, 1955, in the amount of $90.20 payable to the order of Clarence Windle. After receipt of the check, Windle, without authority to do so, changed the date of the check to December 9, 1955, and raised the amount to 14,000 dollars. Windle thereafter placed his name on the reverse side of the check and delivered it to the defendant. The defendant indorsed the check with an unqualified indorsement and sent it through the usual banking channels to the drawee bank for payment. After the alteration had been discovered the plaintiff notified the defendant that the defendant "by its indorsement on said check, warranted said instrument to be genuine, when and as it was a spurious instrument and of no validity." It is not clear that the plaintiff in this case sought recovery from the defendant on the theory that the defendant was liable for breach of warranty or sought recovery on the theory that the payment had been made under a mistake of fact. The court denied the plaintiff's claim.

Attention is called to the language of section 62 of the NIL which sets forth the liability of an acceptor of a bill. Section sixty-two provided in part that the acceptor "engages that he will pay it according to the tenor of his acceptance. . . ." While it is recognized that the instruments involved in both the Illinois and California cases had been certified prior to payment it is thought by this writer that the same result would have been reached by each of these courts if there had been payment without the prior certification. The Kansas case is of particular interest because the Kansas court in effect held payment to be an acceptance and therefore covered by section sixty-two of the NIL. Judge Schroeder, speaking for the Kansas court stated:

"The tenor of the acceptance is determined by the instrument as it is when the drawee pays and that is a bill for the raised amount. That is the bill he accepted and no other, and according to its tenor he has engaged that he will pay it. Converted to the facts in the instant case a check is defined as a bill of
exchange, payable on demand, and actual payment by the drawee is greater than an acceptance by the drawee what is merely a promise in writing to pay.56

This statement is of considerable importance because it is considering payment to be an acceptance and within the purview of section 62. There should be no question but what payment is a form of acceptance and that section sixty-two should apply to payment by the drawee in instances where it would be applicable in the form of an obligation to pay. "The payment of a check includes its acceptance."57 It is noted that in both the Illinois and California cases the drawee-payor had accepted the check prior to actually paying it. While in the Nebraska case the drawee had merely paid the altered check.

Returning to the issue of whether one who indorses an instrument may be held liable for breach of warranty consideration must be given to the effect of sections 66, 52, 191 and 30 of the NIL. Section 66 provides "Every indorser without qualification warrants to all subsequent holders in due course: (1) The matters and things mentioned in subdivisions 1, 2 and 3 of the next preceding section. . . ." Subdivision one of the preceding section stated that an indorser warrants: "That the instrument is genuine and in all respects what it purports to be." Clearly if the instrument had been raised it is not genuine and what it purports to be. Section fifty-two defines a holder in due course as "a holder who has taken the instrument under the following conditions: . . ." Next, looking to section 191 we find a holder defined as follows: "‘Holder’ means the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof.” According to section thirty "an instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. . . ." Reading these four sections together it would follow that the drawee-payor cannot hold an indorser liable for breach of any warranty as the indorser’s liability does not extend to the drawee. Warranties arise where there is a sale of an instrument not when the instrument is merely presented to the drawee for payment. Payment by the drawee of a bill or check does not mean that the drawee has purchased the bill or check. Payment by the drawee extinguishes the

56 Id. at 534, 338 P.2d at 313.
57 Id. at 534, 338 P.2d at 313. See also Louisa Nat’l Bank v. Kentucky Nat’l Bank, 239 Ky. 392, 39 S.W.2d 497 (1931); BRANNAK, NEGOTIABLE INSTRUMENTS § 62, 917-18 (7th ed. 1948).
instrument, it cannot be put into circulation again so as to bind the 
drawer or prior indorsers. The Supreme Court of Kansas cited 
with approval the excellent statement by the Oregon Supreme Court 
in First Nat'l Bank v. United States Nat'l Bank.66

"Manifestly, presentment to the drawee for payment is not 
a negotiation of a check; for payment transmits the paper 
from a negotiable instrument into a mere canceled voucher. 
When paid the check has run its course as a negotiable instru-
ment... It is manifest that the drawee, who pays a check and 
then receives it as a cancelled voucher divested of its character 
as a negotiable instrument, is not 'a holder' within the meaning 
of that term as it is used in negotiable instrument law. It 
follows, therefore, that the negotiable instruments law did not 
write into the indorsement of the defendant any of the war-
ranties proscribed by [sections 65 and 66 of the NIL]. . . ."59

The Kansas court was of the opinion that the plaintiff had no right 
to recover from the party receiving payment on the theory of breach 
of warranty. The court determined that the statutory warranties 
under the NIL are exclusive and preclude all inferences of implied 
warranties.

The court by the way of dicta suggested that section 62 makes 
no exception to cases where the party who received payment had 
been negligent or had acted in bad faith. The court did observe 
that courts had generally recognized that negligence and bad faith 
on the part of the holder was to be treated differently than in the 
cases where he had not been negligent nor had acted in bad faith. 
The courts recognized that as section 62 of the NIL was a codifica-
tion of the doctrine of Price v. Neal, it likewise included the limita-
tions which attached to the doctrine of Price v. Neal. That is to 
say, section sixty-two of the NIL is to be extended to matters not 
included in the doctrine of Price v. Neal but is subject to the limita-
tions to the doctrine which the courts have previously recognized.

**RECOVERY FROM COLLECTING BANK UNDER NIL**

In at least three cases decided subsequent to the adoption of the 
NIL the courts have uniformly denied to the drawee plaintiff the 
right to recover from the drawee funds on an altered check where 
the agent had made settlement with his principal prior to being

66 100 Ore. 264, 197 Pac. 547 (1921).
notified of the alteration. In 1958 the New York court in *Seaboard Surety Co. v. First Nat'l City Bank* the drawee had been put on notice that the party to whom payment had been made by the restrictive character of the indorsement, "received for collection." The court found for the defendant because the restrictive indorsee who had received payment had settled with the restrictive indorser prior to learning of the alteration of the instrument. The court did enter a verdict against the restrictive indorser for the difference between the original tenor of the instrument and the altered amount. It seems that the court permitted the recovery on the theory of breach of warranty, but from the language used by the court this is not altogether clear.

While the opinion in *Aetna Casualty & Surety Co. v. Corpus Christi Nat'l Bank* leaves something to be desired for clarity in respect to when the plaintiff-drawee bank that had paid the altered check just learned that the defendant collecting-bank was in fact only a collecting agent. The position of the court is summarized in the following portion of the opinion:

"At the time the collection bank called up the drawee bank and asked whether or not the check had been paid, it had not at that time paid the proceeds of the raised check to its depositor. The fact that the collecting bank had given a bookkeeping credit for such check is immaterial because up until the proceeds of the check had actually been paid to the depositor (no rights of innocent third person having intervened), the amount of the check could have been charged back to the account of the depositor and there would have been no loss. . . . Under such circumstances it would be inequitable to permit the drawee bank, or any one standing in its position, to recover from the innocent collecting bank."  

The *dictum* in *Citizens' Bank v. Commercial Savings Bank* decision of 1923 is in accord with the two previously considered cases.

**Drawee's Rights Under the UCC**

Section 3-417 of the Uniform Commercial Code, hereafter referred to as the UCC, deals with warranties on presentment and transfer and provides in part:

60 180 N.Y.S.2d 156 (New York City Ct. 1958).
62 Id. at 841.
63 209 Ala. 280, 98 So. 324 (1923).
“(1) Any person who obtains payment or acceptance at any prior transferor warrants to a person who in good faith pays or accepts that . . . (c) the instrument has not been materially altered, except that his warranty is not given by a holder in due course acting in good faith . . . (iii) to the acceptor of a draft with respect to an alteration made prior to the acceptance if the holder in due course took the draft after the acceptance, even though the acceptance provided ‘payable as originally drawn’ or equivalent terms; or (iv) to the acceptor of a draft with respect to an alteration made after the acceptance. . . .

“(4) A selling agent or broker who does not disclose the fact that he is acting only as such give the warranties provided in this section, but if he makes such disclosure warrants only his good faith and authority.”

In the cases decided before the UCC, the drawee who had paid an altered instrument was permitted to recover the difference between the original tenor and altered tenor of the bill from the party who received payment from the drawee-payor. The author has been unable to locate any case in which the drawee-payor was permitted to recover from one who had indorsed subsequent to the alteration and who was not the recipient of payment. It would seem that the fact that a check had been certified subsequent to its alteration and prior to payment should not be treated differently in respect to the drawee-payor’s rights than if the drawee-payor had merely paid the instrument after it had been altered. In those jurisdictions in which the acceptor or certifying bank in the case of a check is held liable on the bill or check according to the tenor of the instrument at the time of acceptance or certification, as in Illinois or California, the acceptor or certifying bank would not be allowed to avoid its acceptance as against the good faith holder for value of a bill or check because of its mistake in accepting or certifying the altered bill or check. The fact that the acceptor had followed his acceptance by paying the instrument would in such jurisdiction prohibit the acceptor from recovering the sum paid on any portion of the payment from an innocent recipient. The acceptor or certifying bank would be denied the right to raise the issue of money paid under mistake of fact. It would be highly illogical to permit the acceptor or certifying bank to recover any portion of the sum paid on such altered instrument and then to permit the holder to recover against the acceptor or the
certifying bank in accordance with the altered tenor of the bill or check. In those jurisdictions in which the acceptor or certifying bank is only liable as an acceptor according to the original tenor of the instrument, logic would dictate that the drawee-payor, upon payment of the bill according to the altered tenor of the bill, could recover back the difference between the original and altered tenor of the instrument. If we were to treat the payment by the drawee-payor as a form of acceptance it would seem to follow that in jurisdictions adhering to the Illinois-California concept the drawee-payor would not be entitled to recover from an innocent party who received payment the difference between the original tenor and the altered tenor of the instrument.

It appears that section 3-417 of the UCC affords to one who has accepted or paid an altered bill, rights and remedies not previously possessed by such drawee-payor.

It is noted that section 3-417 of the UCC starts off in the following language: "Any person who obtains payment or acceptance at any prior transferor warrants to a person who in good faith pays or accepts. . . ." In view of the language used it would seem that one who received payment of a bill or one who acquired the drawee's acceptance, which would include certification, warrants that the instrument had not been previously altered. This section would afford to the drawee who paid an altered check the right to proceed against the person to whom payment had been made on the theory of breach of warranty. The right to proceed by the way of breach of warranty should not be construed as divesting the one paying the altered instrument of his right to recover back the difference between the original tenor and the altered tenor of the bill or check on the theory of money paid under mistake of fact. Prior to the UCC the recovery in such event was usually based on the theory of money paid under mistake of fact. It would seem that the measure of recovery should be the same irrespective of which theory the one paying the instrument might use. However, the statute of limitations might be different depending on the theory of the action. In those jurisdictions where there is a shorter statute of limitations on actions based on implied contracts than on written contracts the drawee-payor might have a longer period in which to institute his action if he proceeded by the way of an action for breach of warranty. For example, the West Virginia Supreme Court of Appeals has held that one who merely indorses a negotiable instrument is subject to the
statute of limitations applicable to written contracts because the indorsement is but an abbreviated form of a written contract.  

As the warranty under this subsection is made by any prior transferor to the one accepting or paying the instrument, the drawee-payor has the right to proceed, by the way of an action for breach of warranty, against one who had previously transferred the altered instrument by delivery alone. Such transferor would be liable to the drawee-payor who paid the bill according to its altered tenor, and to his immediate transferee for breach of warranty as provided in subsection (2) of section 3-417, but not to those through whose hands it passed between his immediate transferee and the party who received payment of the altered bill or acceptance of the instrument. Subsection (2) provides: “Any person who transfers an instrument and receives consideration warrants to his transferee and if the transferor is by indorsement to any subsequent holder who takes the instrument in good faith that . . . (c) the instrument had not been materially altered. . . .” Under subsection (2) the one paying the instrument would not be the transferee of the one who had previously transferred the instrument, nor would the one paying the instrument qualify as a holder.

By the exceptions set forth in section 3-417(c)(iii)(iv) the warranty that the instrument had not been previously altered is not made by a holder in due course in respect to alteration occurring prior to an acceptance of the instrument when the holder in due course acquired the instrument after the acceptance, even though the acceptance contained such language as “payable as originally drawn.” Nor would a holder in due course be charged with breach of warranty in respect to a material alteration where the instrument had been altered subsequent to the acceptance of the bill but prior to the time the accepted bill was paid.

It would seem that every transferor of a negotiable bill of exchange or check, whether by indorsement and delivery or by delivery alone, who was not a holder in due course of the instrument subsequent to the alteration would be liable for breach of warranty to the drawee-payor who paid an altered bill or check, whether or not the drawee-payor had previously accepted the bill or check. If the bill had not previously been accepted, the party receiving payment,

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or a prior transferor, whether he transferred the instrument by indorsement and delivery, or by delivery alone, would be liable on the theory of breach of warranty to the drawee-payor who paid such altered bill for the difference between the original tenor and the altered tenor of the bill.