The Holder of UCC 3-407(2)(a) and the Windfall Discharge

Charles C. Lewis
Campbell University School of Law, lewisc@campbell.edu

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The Holder of U.C.C. Section 3-407(2)(a) and the Windfall Discharge

Charles C. Lewis

I. Introduction

Section 3-407 of the Uniform Commercial Code, entitled “Alteration,” sets out the law relating to alteration of negotiable instruments. Subsection 1 of 3-407 defines alteration in terms of a material alteration and lists three illustrations. Subsection 2 of 3-407 states the general rule of discharge in cases of material alteration: “[A]lteration by the holder which is both fraudulent and material discharges any party whose contract is thereby changed . . . .”

The last clause of section 3-407(2)(a) asserts an express exception to the general rule. If the party whose contract is changed assents to the change or is precluded from asserting the defense of a fraudulent, material alteration, then that party is not discharged on the instrument.

Section 3-407(3) and the introductory clause of section 3-407(2) create a second exception to the general rule. The discharge provided for the party whose contract has been fraudulently and materially altered by the holder may not be asserted against a subsequent holder in due course. Thus, the subsequent holder in due course under section 3-407(3) may enforce a fraudulently and materially altered instrument according to its original tenor. If the alteration is made by competing an incomplete instrument, however, the holder in due course may enforce the instrument as completed.

Section 3-407(2)(b) states a corollary of the general rule of section

* Professor of Law, Campbell University School of Law. B.A. (1968); J.D. (1971), Washington & Lee.

1. U.C.C. § 3-104(1) (1977) defines a negotiable instrument under Article 3; § 3-104(2) labels the negotiable instruments controlled by Article 3 as drafts, checks, certificates of deposit, and notes.

2. U.C.C. § 3-407(1) (1977) defines material alteration as an alteration which “changes the contract of any party thereto in any respect . . . .”

3. U.C.C. § 3-407(1) (1977) states that a material alteration includes changes such as the following: “(a) the number or relations of the parties; or (b) an incomplete instrument, by completing it otherwise than as authorized; or (c) the writing as signed, by adding to it or by removing any part of it.” Id. Section 3-407 makes it plain by use of the word “including” that the above illustrations are not an exclusive list of all possible material alterations.

4. U.C.C. § 3-407(2)(a) (1977). Comment 3(c) provides: Assent to the alteration given before or after it is made will prevent the party from asserting the discharge. “Or is precluded from asserting the defense” is added in the paragraph (a) to recognize the possibility of an estoppel or other ground barring the defense which does not rest on assent.

5. “As against any person other than a subsequent holder in due course . . . .” U.C.C. § 3-407(2) (1977).

6. U.C.C. § 3-302(1) (1977) defines a holder in due course as “a holder who takes the instrument (a) for value; and (b) in good faith; and (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.”

7. U.C.C. § 3-407(1)(b)’s definition of material alteration includes any such change in an incomplete instrument, by completing it otherwise than as authorized. See supra note 3.
3-407(2)(a). If the alteration is not fraudulent, not material, or not made by "the holder," the party whose contract is changed is not discharged. The instrument may be enforced according to its original tenor. If, however, the instrument is altered by completion, it may be enforced according to the authority given the party making the completion.

The general rule, together with its exceptions and corollary, state the law under the Uniform Commercial Code (U.C.C.) for material alteration of a negotiable instrument. In the many articles which have appeared before and after adoption of the U.C.C. by the various states, law review writers gave the practicing bar a similar statement of the law. Only one of the earlier writers, Professor Roy L. Steinheimer, Jr., raised a possible problem of interpretation. Professor Steinheimer asked rhetorically, "What is meant by the provision that the alteration must be 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?"

Except for a student note suggesting some confusion as to the meaning of "the holder," no law review article mentioned this interpretive problem until some ten years later when Professor James J. White began to pull on the tethers and poke at the innards of Article 3. Some six years later, Professor Robert Dugan replied to Professor White's article and challenged his interpretation of "the holder" in section 3-407.

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8. U.C.C. § 3-407 comment 3(d) (1977) provides: "If the alteration is not material or if it is not made for a fraudulent purpose there is no discharge, and the instrument may be enforced according to its original tenor." It says nothing about discharge if a fraudulent and material alteration is not made "by the holder," a conclusion made by the author from the language in § 407(2)(a).


Since Professor Dugan's reply to Professor White, no articles have been written about this interpretive problem and its consequences. The reason for this lack of attention logically rests in the dearth of cases which have approached the problem in the years since Professor Dugan and Professor White wrote. Although no courts have confronted the problem, regulations have been passed and legislation has been proposed which have some effect on the interpretation of "the holder." Certainly, the time has come to review the problems brought about by the confusion regarding who "the holder" is in section 3-407, to assess the validity of the possible interpretations of "the holder," and to explore any cases, legislation and regulations affecting the problem. In addition, since none of the previously written articles have ever analyzed the legislative history of section 3-407 and its predecessor, the Negotiable Instruments Law, or the case law preceding the Negotiable Instruments Law, the time for examination of these sources has also come. The author hopes to reach a conclusion on the interpretive problem and to suggest any changes in the law which might be necessary.

II. THE PROBLEM—A WINDFALL DISCHARGE?

Professor White dramatically illustrated the problem of who qualifies as "the holder" in section 3-407(2)(a) with the following hypothetical:

[A]ssume that a thief steals a $1,000 bearer check and alters the amount to $11,000. The thief then cashes the check at a depositary bank. Upon the presentment to the payor bank, payment is refused because customer has ordered payment stopped. If the thief is a 'holder,' and assuming that the depositary bank is not a holder in due course [assume, for example, that the check is overdue (Section 3-304)], the literal application of 3-407 gives the drawer-purchaser perfectly good merchandise for which he did not have to pay; neither the seller nor the depositary bank will have a cause of action against anyone (due to the discharge). This resultant windfall to the drawer-purchaser is undesirable. How, then, can one avoid it?17

As Professor White suggests by this hypothetical, something is "rotten in the state of Denmark." A purchaser who gives a check in payment

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17. J. WHITE & R. SUMMERS, THE HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE, § 15-5, at 604 n.57 (2d ed. 1980) [hereinafter cited as WHITE & SUMMERS]. Other illustrations of the problem may be found in Dugan, supra note 14 passim.
of goods should not, in the end, be able to keep those goods without paying for them. In addition, it seems unreasonable that the depositary bank, which is not a holder in due course for reasons completely unrelated to the alteration, may not enforce the check for at least the original tenor, the amount the purchaser-drawer of the check agreed to pay in the beginning. So unfair seemed the situation to Professor White that he questioned whether the windfall discharge permitted by section 3-407 did more harm than good, and whether it might be better if it were removed.\(^\text{18}\)

The above hypothetical may seem an isolated factual situation which, although dealt with harshly by the Code, will rarely occur. After all, usually the party who takes from the thief will be a holder in due course and be able to sue the drawer for the amount of the original tenor.\(^\text{19}\) If the party who takes from the thief is not a holder in due course, it is usually because he took with notice of the alteration;\(^\text{20}\) in such a case, the party is perhaps legitimately punished for doing so. Also, the drawer of the check may have had it stolen from him, as in Professor White's hypothetical, so that he never gave the check in return for goods; thus, if discharged, he is not unjustly enriched because he never received the goods.

Indeed, both Professors White and Dugan, in exploring the problem, have suggested that the problem does exist, but that it is nothing to get terribly excited about. Professor White entitled his original article that explored the problem, "Some Petty Complaints About Article 3" and in it stated that none of the complaints he made were "fundamental"; they were "petty" at least in the sense that no cases had yet manifested any difficulty with the problem.\(^\text{21}\) Professor Dugan, who wrote in reply to Professor White's article, suggested that the problem arose in "several unusual factual situations."\(^\text{22}\)

Neither Professor White nor Professor Dugan, however, approached the problem head on. Instead, both directed their articles at the more general problem concerning the interpretation of the "holder" definition under several sections of the Code. The interpretive problem of "holder" specifically in section 3-407(2)(a) was only a part of their discussions. In addition, the issue addressed by both professors was whether a thief could or should be a holder; therefore, their factual situations always involved a thief who either stole a bearer instrument or an instrument made payable to the order of the thief. The narrow scope of

\(^{18}\) White & Summers, supra note 17, at 605.
\(^{19}\) U.C.C. § 3-407(3) (1977).
\(^{20}\) U.C.C. § 3-304(1)(a) (1977) would thus put the taker on notice of a claim or defense so that the taker would not be a holder in due course under § 3-302(1)(c).
\(^{21}\) White, supra note 13, at 1315.
\(^{22}\) Dugan, supra note 14, at 1.
the issue they addressed thus limited their view of the interpretive problem and made it seem somewhat petty and remote.

One need not, however, think of this problem arising only with a thief. Take, for example, the simple factual situation in which a purchaser gives a seller a check in return for goods delivered to him. The seller, who would ordinarily be a holder under the Code, fraudulently and materially alters the check before depositing it in his depositary bank or negotiating it to a third party. Assume the drawee bank does not pay the check because there are insufficient funds in the drawer's account, since the altered check is for a much larger amount than the drawer-purchaser intended. If the depositary bank or the third party, as the case may be, is a holder in due course, then either could enforce the check against the drawer-purchaser for at least the original tenor. Thus, the drawer-purchaser would get no windfall since he would be paying exactly what he contracted to pay for the goods. If, however, the depositary bank or the third party is not a holder in due course, then the result is that suggested by Professor White: a windfall discharge to the drawer-purchaser and a complete loss to the depositary bank or the third party. If the reason the depositary bank or the third party is not a holder in due course is something unrelated to the alteration (Professor White's suggestion of an overdue check is an excellent example), then it seems a harsh result that neither party could sue even for the original tenor.

This hypothetical situation without a thief, of course, is perhaps subject to the same criticism that Professors White and Dugan leveled against their own hypotheticals. Ordinarily, it would not produce a windfall discharge because the depositary bank or the third party will generally be a holder in due course. In addition, if a holder in due course has taken from the person who altered the check, subsequent non-holders in due course may be protected by the shelter provision. In short, the problem may exist, but is it likely to occur?

Such criticism might indeed be valid if the holder in due course doctrine had not been so successfully attacked in the past and if the likelihood of future attack were not so imminent. Although the assault on the holder in due course citadel perhaps began with Unico v. Owen in 1967, the most serious assault against the doctrine came in May of 1976 when the Federal Trade Commission passed a regulation making it an unfair

23. WHITE & SUMMERS, supra note 17, at 604 n.57.
or deceptive act for a seller to take a consumer credit contract which failed to include certain boldface language. The effect of that language is to abolish holder in due course status for any holder of promissory notes within the scope of the F.T.C. regulations. Thus, the F.T.C. regulations have created and will continue to create a large class of note holders who cannot be holders in due course and who thus cannot seek the protection of section 3-407(3) in the event of a fraudulent and material alteration of a note by a prior holder.

In addition, the "3-4-8" Committee of the U.C.C.'s Permanent Editorial Board drafted a provision for the abolition of holder in due course status for transferees of consumer checks in the Uniform New Payments Code. Although this provision, along with other consumer related provisions, is no longer being considered, if Congress or the individual state legislatures eventually pass such a provision, a large class of check holders will be created who cannot be holders in due course and, like the note holders mentioned above, cannot seek the protection of section 3-407(3) in the event of a fraudulent and material alteration of a check by a prior holder.

With these developments, consider the hypothetical situation in which a dealer sells an appliance to a consumer for $500, and the consumer, without any negligence contributing to a later alteration, either writes a check for it or signs a promissory note. The dealer then skillfully raises the amount in the check or promissory note and negotiates the instrument to a third party who takes the paper. Finally, the check is not paid by the drawee bank or the promissory note is not paid by the maker. Assuming the promissory note is covered under the F.T.C. regulations and the check under legislation similar to the consumer check provisions of the Uniform New Payments Code, holder in due course status will be taken away from the innocent third party who was unaware of the alteration. Assuming the dealer has skipped town, the consumer

33. The consumer's negligence which substantially contributes to a material alteration would preclude the consumer from asserting the alteration. U.C.C. § 3-406 (1977).
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has a windfall discharge, and the third party, by force of regulation or legislation, loses everything.

Of course, each of the above hypotheticals assumes that the altering party is "the holder" under section 3-407(2)(a) and that the resulting windfall discharge was intended by the drafters. Exactly who the drafters intended to include by the phrase "the holder" in section 3-407(2)(a) and whether that holder's acts can discharge another party's contract as to a third party has been the subject of debate.

III. ANALYSIS OF WHO QUALIFIES AS HOLDER UNDER SECTION 3-407(2)(a)

Most of the law review articles on section 3-407 ignore the issue of who qualifies as the holder under section 3-407(2)(a).34 If there is a standard interpretation, it is that the term "the holder" in section 3-407(2)(a) means "a holder." In other words, a fraudulent and material alteration by any holder will result in the discharge of any party whose contract has been changed. At the opposite pole is the interpretation that "the holder" means only the plaintiff in an action on an altered note or check; that is, the maker's or drawer's contract is discharged only as to the wrongdoer/holder who both fraudulently and materially altered the instrument.

Hart and Willier acknowledge that use of the article "the" rather than "a" to describe the holder in section 3-407 has created confusion.35 Logically, however, they state that

[i]f the plaintiff is a subsequent holder in due course against whom an alteration may be afforded only a limited discharge, then "the holder" must necessarily refer to some holder prior to the plaintiff. It follows that "the" means "a"; and thus, the maker must only show that a holder, as opposed to a stranger or even a non-holder transferee, somewhere up the line committed the alleged act.36

Without even discussing whether "the" means "a", other writers simply substitute "a" for "the" when discussing section 3-407(2)(a).37

Professor White certainly agrees with the standard interpretation. In his example of the thief who fraudulently makes a material alteration on a stolen check, the third party to whom the check is negotiated finds that the drawer of the check is discharged if the third party is not a holder in due course and the thief is a holder.38 Professor White, in his early law review article, even proposed a revision39 of section 3-407(2)(a)

34. See supra note 9.
35. 2 F. HART & W. WILLIER, supra note 30, at 5-19. They admit that using the article "the" rather than "a" to describe the holder could be interpreted to mean that the holder who is plaintiff must have been the wrongdoer.
36. Id.
38. White, supra note 13, at 1317.
39. Id. at 1338. Professor White's proposed revision is as follows: "Alteration which is both
which substituted “a” for “the” exactly as called for by Hart and Willier. He echoes Hart and Willier’s reasoning that “the” could not actually mean “the” in section 3-407(2)(a) because such an interpretation would “render superfluous section 3-407(3) and the introductory phrase, ‘other than a subsequent holder in due course’ of subsection (2).”

Other than the discomfort one may feel in boldly stating that the drafters used “the” in section 3-407(2)(a) when they really meant “a”, the primary criticism of the standard interpretation of “the holder” is the windfall discharge mentioned earlier. Professor White, after recommending that “the” be changed to “a” in his proposed revision of section 3-407(2)(a), suggested (in a footnote) the abolition of the discharge provision because of its windfall effect.

As noted previously, Professor Steinheimer first recognized the interpretive problem concerning the holder in section 3-407(2)(a) and suggested the possibility that “the holder” might refer to “the holder at the time the claim is made and the defense asserted” rather than to “any holder.” Professor Dugan, as mentioned earlier, took up Professor Steinheimer’s suggestion and proposed that “the holder” means the plaintiff who seeks to recover on the instrument. Rather than looking to the language of section 3-407(2)(a) to find support for his interpretation, Professor Dugan hypothesized a suit in which the plaintiff sought to recover on an instrument. In such a suit, the plaintiff would ordinarily be entitled to recover upon the production of the instrument under section 3-307(2), unless, of course, the defendant presented a defense. In that case, suppose the defense were a fraudulent and material alteration under section 3-407(2)(a) which the defendant contends should discharge him on the instrument. In asserting this defense, the defendant must, according to Professor Dugan, demonstrate the existence of an alteration by “the holder” as called for by section 3-407(2)(a). Assuming that the plaintiff is not the one who altered the instrument, the plaintiff could successfully rebut the defense by showing that he, the present holder, did not alter the instrument. Since “the holder” means just that in the suit under Professor Dugan’s interpretation, section 3-407(2)(a) does not apply to discharge the defendant on the instrument.

Professor Dugan’s proposed interpretation seems to have happy results. It avoids the prickly problems raised by Professor White as to

fraudulent and material by a holder who acquired possession by delivery discharges any party whose contract is thereby changed unless that party assents or is precluded from asserting the defense.” Id.

40. Id. at 1338 n.70.
41. Id. Professor White has continued to disapprove the windfall discharge effect of § 3-407(2)(a) and to suggest its abolition. See WHITE & SUMMERS, supra note 17, at 605 n.57.
42. R. STEINHEIMER, MICHIGAN NEGOTIABLE INSTRUMENTS LAW, supra note 10, at 92; Steinheimer, Impact of the Commercial Code, supra note 10, at 185. He did not, however, suggest which interpretation was correct.
43. Dugan, supra note 14, at 22.
44. Id.
whether a thief can or should be a holder, and it eliminates the ill effects of the windfall discharge for which even Professor White criticized his own interpretation.

Professor Dugan's interpretation also eliminates the need seen by Professor White to amend section 3-407(2)(a) by substituting "a" for "the" before "holder." Indeed, Professor Dugan's thesis was that the problems suggested by Professor White in Article 3 were not the result of the drafters' ineptitude, but rather because of incomplete interpretation of the relevant Code sections.

Professor White's reply to Dugan's proposed interpretation would presumably be the same as his response to Professor Steinheimer's suggestion that "the holder" might possibly mean "the holder at the time claim is made and the defense asserted." According to Professor White, to interpret "the holder" to mean the holder who instituted the suit would render superfluous section 3-407(3) as to the holder in due course and the introductory phrase, "other than a subsequent holder in due course," in subsection 2.

Such a response to Professor Dugan's analysis of "the holder" certainly has merit. If "the holder" of section 3-407(2)(a) means the "plaintiff holder" so that the section applies only when a plaintiff holder makes a material and fraudulent alteration on an instrument, a plaintiff holder who has not made such an alteration would never need to seek holder in due course status under section 3-407(3) in order to sue for the original tenor. Under section 3-407(2)(b), which covers all situations not expressly covered by section 3-407(2)(a), the non-altering plaintiff holder, whether a holder in due course or not, may sue for the original tenor or the completed amount, as the case may be.

Both interpretations of "the holder" under section 3-407(2)(a) leave one feeling somewhat uneasy. Professor White's interpretation requires one to read the language of section 3-407(2)(a) differently from the way it was drafted and would sometimes result in an undeserved windfall discharge to a purchaser-drawer/maker and a harsh penalty to an innocent third party. Professor Dugan's interpretation, however, allows one to read the language as the drafters actually wrote it and eliminates the ill effects of the windfall discharge, but it unfortunately obviates a signifi-

45. White, supra note 13 passim.
46. Of course, a purchaser, whether as drawer or maker, may still obtain a windfall discharge even under Professor Dugan's interpretation if his seller fraudulently and materially alters the instrument, and then sues the purchaser on it. The seller could not enforce the instrument because of section 3-407(2)(a) since he, as plaintiff and holder, made the fraudulent and material alteration, but presumably the seller's punishment and the purchaser's windfall would be justified in light of the seller's fraudulent action. At any rate, no innocent third party would suffer in such a case.
47. Dugan, supra note 14, at 2.
49. WHITE & SUMMERS, supra note 17, at 604 n.57; White, supra note 13, at 1338 n.70.
cant portion of section 3-407. No other interpretation for "the holder" in section 3-407(2)(a) has been offered, and the phrase itself does not appear susceptible to a third interpretation. Thus, a conclusive answer as to the identity of "the holder" under section 3-407(2)(a) cannot be found in the statutory language and must be sought elsewhere.

IV. THE COMMON LAW RULE BEFORE CODIFICATION

Neither Professor White nor Professor Dugan offer any authority for their interpretations other than the express language of section 3-407 or the logic behind the section. If they had examined the prior law of alteration, they did not mention it in their articles. Nevertheless, justification for certain statutory language and its interpretation may often be found in the common law as it stood prior to a statute, or in previous statutory provisions.

The provisions of the U.C.C., of course, evolved from the common law of England and America and from later codifications in both Great Britain and America. Section 3-407(2)(a)'s phrase, "the holder" should thus be examined in light of that prior law. Although such an examination suggests no new interpretation for "the holder," it supports the standard interpretation that "the holder" means "a holder." Paradoxically, that same examination reveals that, in light of the great changes in the law of alteration over the past century, section 3-407(2)(a) no longer furthers the theory and policy of that prior law which supports the standard interpretation.

The official comments of the U.C.C. state that section 3-407 is derived from the Negotiable Instruments Law, the first American codification of the law of negotiable instruments.50 The ancestry of section 3-407 can, however, be traced further to the common law existing in America prior to the promulgation of the uniform law.51 The American common law, of course, had its roots in the common law of England.

A. The English Source of the Common Law Rule

In the case of Wood v. Steele,52 the United States Supreme Court considered the effect of an alteration upon a negotiable instrument. The Court applied the rule that "a material alteration in any commercial pa-

51. Fairfax Leary, Jr., assistant reporter for Article 3 and the initial reporter for Article 4, states the following as the source material studied by the reportorial staff of the Code charged with the responsibility for Article 3: the Negotiable Instruments Law, fifty-odd years of court decisions under that uniform act, the common law prior to the Negotiable Instruments Law, the British Bills of Exchange Act and the decisions interpreting it, the various law review articles written about both statutes, and, in particular, the celebrated controversy between Judge Brewster and Dean Ames of Harvard. Leary, Commercial Paper: Some Aspects of Article 3 of the Uniform Commercial Code, 48 Ky. L.J. 198, 202 (1960).
52. 73 U.S. (6 Wall.) 80 (1867). A material alteration as to the date discharged completely a surety as against an innocent holder.
per, without the consent of the party sought to be charged, extinguishes his liability," a representative statement of the common law rule as it was applied in America. The Court traced the rule to the time of Edward III when an erasure in a deed would avoid it. The rule evolved more fully in Henry Pigot’s Case when the King’s Bench held that when any deed is altered in a point material, by the plaintiff himself, or by any stranger, without the privity of the obligee, be it by interlineation, addition, raising, or by drawing of a pen through a line, or through the midst of any material word, . . . the deed thereby becomes void . . . .

Pigot’s Case does not mention the policy for this rule, but one may at least conclude the theory supporting discharge from the plea allowed the defendant: non est factum, that it is not his deed. After alteration, the instrument is no longer the obligor’s and thus cannot be enforced against him.

Samuel Williston suggested that the original reason a deed was discharged by alteration was that “the deed was itself the obligation, not merely the evidence of it, and if the deed ceased to exist in its original form the obligation necessarily ceased.” Although Pigot’s Case did not suggest such a theory for discharge, Williston’s suggestion seems to fit

53. Id. at 82.
54. Edward III was King of England from 1327 to 1377.
55. 77 Eng. Rep. 1177 (1614). Henry Pigot signed a bond for the payment of money to Benedict Winchcombe, Esq., on the condition that George Watkins would appear in the King’s Bench to answer to George Cottil in a plea of trespass. Apparently, George Watkins did not appear and Benedict Winchcombe, who happened to be the Sheriff of Oxford County, sued Henry Pigot on the bond. In defense, Pigot claimed that the bond had been altered after he signed it by the insertion of “Sheriff of the County of Oxford” after Winchcombe’s name. The jury found that an alteration had indeed been made. Id. at 1178.
56. The term “deed” used in Pigot’s Case does not have the narrow meaning it has today. The broader meaning of “deed” is “a writing sealed and delivered by the parties,” BALLENTINE’S LAW DICTIONARY 318 (3d ed. 1969), a definition broad enough to include a bond or a covenant in a deed, both of which had to be under seal in the time of Edward III. Indeed, Pigot’s Case does not involve a suit on a deed of conveyance of real estate, but rather an action on a bond.
57. Sine notitia in Latin or “without notice” as we know it in English today.
58. Pigot’s Case, 77 Eng. Rep. at 1178. The opinion in Pigot’s Case goes into further detail: So if the obligee himself alters the deed by any of the said ways, although it is in words not material, yet the deed is void: but if a stranger, without his privity, alters the deed by any of the said ways in any point not material, it shall not avoid the deed.
59. Id. at 1177.
60. Non est factum has also been interpreted to mean “there was no such document, or covenant.” C. REMBAR, THE LAW OF THE LAND 225 (1980).
61. Williston, Discharge of Contracts by Alteration, 18 HARV. L. REV. 105, 107 (1904). Oliver Wendell Holmes had earlier suggested the same reason for the rule. He wrote, “This rule comes down to us from a time when the contract contained in a sealed instrument was bound so indissolubly to the substance of the document that the soul perished with the body when the latter was destroyed or changed in its identity for any cause.” Bacon v. Hooker, 177 Mass. 335, 337, 58 N.E. 1078, 1079 (1901). Greenleaf suggests a similar idea: “The instrument derives its legal virtue from its being the sole repository of the agreement of the parties, solemnly adopted as such, and attested by the signature of the party engaging to perform it.” S. GREENLEAF, A TREATISE ON THE LAW OF EVIDENCE § 565, at 704 (16th ed. 1899).
well with the plea of *non est factum* allowed in *Pigot's Case*. According to Williston, the original unaltered deed was entirely destroyed by the alteration and thus could not be enforced against the obligor. According to *Pigot's Case* and its plea of *non est factum*, the resulting altered bond was a new instrument and not the bond of the obligor so that neither the new nor the original bond could be enforced. Although Williston's reason for discharge lost significance as courts of equity and later courts of law began to accept secondary evidence of a deed, the plea allowed in *Pigot's Case*, *non est factum*, and the theory implied by it became part of the American common law rule.

The rule in *Pigot's Case* was originally applicable only to the alteration of an instrument required to be under seal, such as a bond or a deed. Although both a bill of exchange and a promissory note are similar to a bond for the payment of money, neither instrument was originally required to be under seal, and thus the holding in *Pigot's Case* as to alteration did not automatically apply to them.

Whether the rule in *Pigot's Case* should be extended to apply to an instrument not under seal, such as a bill of exchange, finally arose in the famous English case of *Master v. Miller*. In *Miller*, Peele and Company drew a bill of exchange on Miller, payable three months after its date to Wilkinson and Cook. Miller, the drawee and the defendant in the suit, accepted the bill of exchange, and Peele and Company delivered the bill to Wilkinson and Cook. Apparently, the date of the bill of exchange was altered while it was in the hands of Wilkinson and Cook. At any rate, an ink blot appeared over the date so that March 26 looked like March 20, thus advancing the time of payment of the bill of exchange. In addition, the notation “June 23” was added, indicating the time of payment based

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64. Today, we would call this instrument a draft rather than a bill of exchange.
65. Not only did the bill of exchange become a contract to pay money when it was accepted by the drawee, but it, like the bond or deed, was itself the obligation and not merely evidence of it. Williston, *supra* note 61, at 112. Williston quoted Justice Holmes in Blackstone v. Miller, 188 U.S. 189, 206 (1903). “Bonds and negotiable instruments are more than merely evidences of debt. The debt is inseparable from the paper which declares and constitutes it, by a tradition which comes down from more archaic conditions.” *Id.* This aspect of a negotiable instrument is known as the “doctrine of merger.”

Merger means that, once an obligation has been put into the form of a negotiable instrument, the obligation must be dealt with through dealings in the instrument. The instrument is not merely the best evidence of the current state of the obligation. Rather, the instrument is the obligation. The obligation has become locked up in the instrument in such a way that interests not indicated on the instrument are subordinated to the rights which the instrument contains.

66. 100 Eng. Rep. 1042 (1791). The United States Supreme Court also recognized *Master v. Miller*, as well as *Pigot's Case*, as the source of the common law rule on alteration which it applied in *Wood v. Steele*, 63 U.S. (6 Wall.) 80 (1867).
on the altered date of March 20. Sometime later, Wilkinson and Cook endorsed the bill to the plaintiffs, Master and others, for valuable consideration. Miller later refused to pay the bill of exchange, and the plaintiffs sued.

The result of *Master v. Miller* was, perhaps, inevitable. The three judges in *Master v. Miller* who agreed that the rule in *Pigot's Case* should be extended to the bill of exchange seemed to believe that the policy underlying the rule in *Pigot's Case*, rather than the similarity between the bond and the bill of exchange, required the extension of the rule. Lord Kenyon, the chief judge, asked rhetorically, "[W]hy, in point of policy, would [the alteration] have . . . that effect [avoidance] in a deed?" He answered his own question by responding, "Because no man shall be permitted to take the chance of committing a fraud, without running any risk of losing by the event, when it is detected." If that same policy applied to the alteration of a bill of exchange, then the rule of *Pigot's Case* should, Lord Kenyon thought, be extended to the bill of exchange under the proposition that "the law went as far as the policy." Naturally, the same policy did apply to the alteration of a bill of exchange. "It is one of the greatest importance," wrote Lord Kenyon, "that these instruments which are circulated throughout Europe, should be kept with the utmost purity, and that the sanctions to preserve them from fraud should not be lessened." Thus, the alteration of the bill of exchange avoided it, and Lord Kenyon would not allow the holders to recover on it.

Judge Buller was the only judge who disagreed in *Master v. Miller*. He did not generally dispute the extension of the rule in *Pigot's Case* to the bill of exchange, but he did vigorously deny that the rule should be applied to the facts of *Master v. Miller* to discharge the obligation of the drawee. In objecting to the outcome of the rule's application in the case before him, he discussed several issues which later became important with respect to "the holder" of section 3-407(2)(a): the problem of the windfall discharge, the status of the bona fide purchaser for value, the relevance of fraudulent intention in alteration, and the problem of alteration by a stranger.

Judge Buller's overall concern in *Master v. Miller* was that the defendant would have a windfall discharge if the court did not allow the plaintiffs to enforce the bill of exchange. He noted that the bill of exchange was given for a full and valuable consideration, that the plaintiffs

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68. Id.
69. Id. at 1048.
70. Id. at 1047.
71. Id. at 1048.
72. Id.
were honest and innocent holders of it, and that the defendant had the amount of the bill in his hands. He would therefore have allowed the plaintiffs to recover from the defendant, either on the instrument itself or on the basis of money had and received. Said Judge Buller, "The defendant has got that money in his pocket, which in justice and conscience the plaintiffs ought to have, and therefore they are entitled to recover it . . . ." Judge Buller's complaint is remarkably similar to that of Professor White some 250 years later.

A second issue raised by Judge Buller arose out of his description of the plaintiffs as honest and innocent holders of the bill of exchange for a full and valuable consideration. The facts were certain that the plaintiffs did give value for the bill of exchange and that they did not alter the instrument, since the blot and the insertion of "June 23" were made before the bill of exchange was delivered to the plaintiffs. The jury never found that the plaintiffs did not take with notice as a result of the alteration, but none of the three judges who applied the rule to the detriment of the plaintiffs suggested that the plaintiffs had taken it in bad faith or with knowledge of the alterations. Judge Buller maintained that the plaintiffs were honest and innocent holders of the bill of exchange. In short, Judge Buller suggested that a party who took an instrument for value, in good faith and without notice, should be allowed to recover the amount of the bill of exchange despite the alteration. As discussed later in this article, Judge Buller's objection to allowing a bona fide purchaser for value (the counterpart of our modern holder in due course) to lose in this situation would await recognition until passage of the Bills of Exchange Act in Great Britain and the Negotiable Instruments Law in America. For the time being, however, the English common law rule steadfastly provided that alteration was the type of defense that could be asserted against a bona fide purchaser for value even as to the original

73. *Id.* at 1052.
74. WHITE & SUMMERS, *supra* note 17. Judge Buller's recognition that a windfall discharge existed did not go unnoticed, although it certainly went unheeded. John Faquhar Fraser of Lincoln's Inn, a Barrister-at-Law, annotated cases appearing in the English Reports with notes and references to other cases. In his annotation of *Pigot's Case*, he naturally cited Master v. Miller and the rule which it established. Without reference to Judge Buller's concern over the windfall discharge, he noted, "And when the acceptance of a bill is altered in the material part by the holder, neither he nor any claiming through him can recover upon the bill." *Pigot's Case*, 77 Eng. Rep. at 1179. Out of this rule, of course, comes the windfall discharge. Fraser cites two English cases for this proposition, both of which arose after Master v. Miller: Tidmarsh v. Grover, 105 Eng. Rep. 274 (1813) and Cowie v. Halsall, 106 Eng. Rep. 910 (1821). Neither of these cases expressly states Fraser's rule, but the described result is obvious. In each case, the drawer drew a bill of exchange to himself on a second party who accepted the bill of exchange. Later the drawer/payee negotiated the bill of exchange to a third party who then sued the acceptor. In each case, however, the drawer/payee had made an alteration that both courts determined was material. Also, in each case, the third party, who was the endorsee of the drawer/payee, could not enforce the instrument, leaving the acceptor with the windfall discharge.
76. *Id.* at 1050.
A third issue raised by Judge Buller was the issue of fraud. He asked for what purpose the alteration was made in this case. In discussing the blot over the date, he said, "[W]e do not find that it was done for any bad purpose, or with any improper view whatever. Upon this finding, the Court are bound to say it was done innocently."

In discussing the insertion of "June 23" on the bill of exchange, he said, "[B]ut was it done fraudulently? The answer is, it was not, and therefore it is of no avail. So here the jury have not said it was done fraudulently; and therefore it affords no objection."

Unfortunately, as discussed later, Judge Buller's analysis would await realization until the U.C.C. proposed that an alteration must be both material and fraudulent before discharge occurs.

Judge Buller raised a fourth issue in his opinion by asking who made the blot on the bill of exchange and who put the insertion on the bill of exchange. The jury, he commented, did not answer either question. He pushed the issue no further, perhaps because the rule in Pigot's Case had plainly stated that a material alteration by the plaintiff or "by any stranger" would avoid the deed. The outcome in Master v. Miller, of course, was that the bill of exchange was discharged despite the fact that no one knew who made the alterations. Thus, it remained the English rule that a person who altered the instrument need not be the holder; so long as he altered the instrument, a stranger, such as an agent of the obligor or of the obligee acting without authority, or a thief or other wrongful possessor, would avoid it just the same as if the alteration were by the holder. As will be discussed later, the American rule would develop differently.

This examination of the source of the common law rule in England does more than merely trace the development of the rules on alteration for negotiable instruments. It also shows that the theory behind the rule—that the instrument cannot be enforced because its identity is destroyed—and the policy behind the rule—to prevent and punish tampering—were both articulated when the rule was first applied, suggesting the importance of both theory and policy to those early judges who applied the rule despite its harsh effects. As discussed in the following section, both theory and policy remained in full bloom alongside the English
common law rule as they crossed the Atlantic to be incorporated in the 
American common law rule.

Examination of the English common law rule shows, in addition, 
that the windfall discharge issue was recognized in Master v. Miller, 
the very first case in which the rule on alteration was applied to a negotiable 
instrument. Judge Buller's complaint about the windfall discharge sug-
gests that its ill effects did not result from the standard interpretation of 
"the holder" in U.C.C. section 3-407(2)(a), but rather were present from 
the time the rule was first extended to a negotiable instrument. Thus, the 
eyearly English common law rule seems to support the standard interpreta-
tion of section 3-407(2)(a), that "the holder" means "a holder," since any 
holder who altered an instrument discharged it for a subsequent holder 
under the earliest rule. Presumably, the harsh result of this interpreta-
tion was justified by the theory and policy articulated by the early Eng-
lish judges.

Finally, examination of the English common law origin suggests 
three additional issues: the status of the bona fide purchaser for value, 
the relevance of fraudulent intent, and the impact of alteration by a 
stranger. These issues would be resolved by later codifications: the Ne-
gotiable Instruments Law (N.I.L.) and the U.C.C. Although none of 
these issues seem to bear directly on the question of who the holder is 
under U.C.C. 3-407(2)(a), the resolution of all three under later codifica-
tions will nevertheless help to suggest an answer.

B. The Common Law Rule in America

Under the American common law prior to the N.I.L., the general 
rule applicable to altered instruments was the same as the English com-
mon law rule: a material alteration of a negotiable instrument dis-
charged a party who had not consented to the alteration.83 Like the 
English common law rule, the discharge resulting from a material altera-
tion of an instrument was, under the American common law rule, a real 
defense which could be asserted even against what was then known as a 
bona fide purchaser,84 a counterpart of our modern holder in due 
course.85

A pre-N.I.L. case which illustrates the use of material alteration as a

83. "This rule is so well established as to require no citation of authorities." Annot., 86 AM. 
ST. REP. 80, 118 (1900). Nevertheless, see cases collected in Annot., 86 AM. ST. REP. 80, 82-83 
(1900).
84. M. BIGELOW, THE LAW OF BILLS, NOTES, AND CHECKS 574 (2d ed. 1880); W. BRITTON, 
supra note 82, § 285, at 1078; 1 I. EDWARDS, A TREATISE ON BILLS OF EXCHANGE § 244, at 192 
(3d ed. 1882); W. MOORE & H. WILKIE, NORTON'S HANDBOOK OF THE LAW OF BILLS AND NOTES 
§ 105, at 319 (4th ed. 1914); 2 T. PARSONS, supra note 82, at 544; Williston, supra note 63, at 173; 
see Annot., 86 AM. ST. REP. 80, 121 (1900) (cases collected). If the alteration was immaterial in that 
it did not change the legal effect of the instrument, no discharge occurred. 1 J. AMES, A SELECTION 
of Cases on the Law of Bills and Notes 449 (1894); Williston, supra note 63, at 166.
85. 1 J. DANIEL, supra note 82, § 769, at 576; 1 T. PARSONS, supra note 63, at 254.
real defense against the bona fide purchaser is *Wade v. Withington*. In this case, a holder of a promissory note sued the maker for $140. The maker denied making the note, alleging that it had been fraudulently altered after it was signed by the addition of the words "and forty" to make it appear to be a note for $140 instead of $100. When the maker testified in court about the alteration of the note, the holder objected because the alteration could not be detected by the most careful scrutiny and because he maintained that the defense of alteration and its resulting discharge was not open against him, a bona fide endorsee for valuable consideration. The trial judge nevertheless allowed the maker to assert the alteration against the holder, and the Massachusetts Supreme Court affirmed. Thus, the discharge resulting from the alteration was successfully asserted against even a bona fide purchaser for value.

Case opinions prior to the N.I.L. expounded both theory and policy for this discharge, windfall or otherwise, and the treatises of that day echoed the same theory and policy. The court in *Wade v. Withington*, for example, said that the well settled doctrine, that a material alteration of a bill or note vitiated the instrument except as against parties consenting to the alteration, rested on the principle that the parties can be held liable only on their contract as originally made and entered into by them. Once a material alteration is made without the privity of the party liable upon it, said the court, the instrument ceases to be the maker's contract and thus the instrument cannot be enforced at all against the maker. The court then noted that the common law ordinarily gave peculiar sanction to negotiable paper like the note in this case in order to secure its free circulation and to protect bona fide holders for value who take it before maturity, just as the holder in this case had. However, the court said that the protection ordinarily given bona fide holders for value did not extend so far as to hold liable a party, like the maker in this case, on a contract into which he had never entered and into which he had not given his assent.

*Gettysburg National Bank v. Chisholm* is a similar case which applied the common law rule for a materially altered instrument. The Pennsylvania Supreme Court refused to allow a holder, who claimed to be an innocent purchaser for value, to sue on an altered instrument for the original tenor. The instrument in that case had been materially altered by addition of "with interest at 6 percent," but the endorsee, who

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86. 83 Mass. 561 (1883).
89. 32 A. 730 (1895).
90. The court said that it was not proven, and it probably was not possible to prove, that the endorsee acquired the note innocently because the interlineation "with interest at 6%" was apparent on the face of the note and was sufficient to put the plaintiff on inquiry. *Id.* at 731.
held the note, was quite willing to enforce it for only the original tenor. The court nevertheless refused to enforce the altered instrument even for the original tenor.

Instead of basing its decision on the theory that the maker's contract had been destroyed by the alteration as held in *Wade v. Withington*, the Gettysburg Bank court based its decision upon the public policy of imposing a severe penalty as a safeguard against tampering with written instruments. The court's reason for refusing to allow even an innocent purchaser for value to enforce the note for its original tenor was that

[i]f such were the law, forgeries by alteration would be protected by the law. The fraudulent payee would run no risk of loss, because he would only have to transfer the note to an indorsee, who might recover the original amount of the note by simply proving that he was innocent of the fraud. But the law is not so charitable to this class of persons.\(^9\)

The court stated that the basis for denying enforcement even for the original tenor was the policy of discouraging fraud and alteration of instruments.\(^9\) The resulting complete discharge, said the court, took away the motive for alteration because the holder in effect forfeited the instrument on discovery of the fraud.\(^9\)

*Commonwealth v. Immigrant Industrial Savings Bank*\(^9\) summed up both theory and policy for the rule of allowing alteration and its resulting discharge as a real defense against even bona fide purchasers for value. The court said,

[T]he reasons given in the text-books and adjudged cases for the rule that a material alteration avoids a written instrument are two: first, that no man shall be permitted on grounds of public policy, to take the chance of committing a fraud without running any risk of losing by the event when it is detected; the other, that the identity of the instrument is destroyed.\(^9\)

Thus, the same theory and policy supporting both the English and the American rules were deemed to justify the harshness of both.

The windfall discharge criticized by Judge Buller in *Master v. Miller* could occur just as easily under the American common law rule as under the English common law rule. For example, if the maker of the note in *Wade v. Withington* had received goods or services in exchange for the note, he would have received a windfall discharge at the expense of the good faith holder for value when the court held the note discharged by the alteration. Indeed, many pre-N.I.L. cases involved the same fact pattern as in *Wade v. Withington* with a possible windfall discharge at the

\(^{91}\) *Id.*
\(^{92}\) *Id.*
\(^{93}\) *Id.* at 732.
\(^{94}\) 98 Mass. 93 (1867).
\(^{95}\) *Id.* at 93. Alteration of several bonds in this case did not bring about discharge because the alterations were not material.
expense of a good faith holder for value. No case, however, explicitly mentions that a windfall occurs or complains about it, but it is evident from the facts that a windfall could have occurred. Even Samuel Williston admitted that an obligor of an altered instrument may be able to keep the consideration which he has received without giving any equivalent value for it.

One case which did apparently recognize the windfall discharge resulting from alteration suggested a possible way to avoid that result. In *Hunt v. Grey*, the plaintiff's agent sold a horse and took back a promissory note payable to the plaintiff. After showing the note to the plaintiff, the agent then discounted the note at a bank and returned the proceeds to the plaintiff. Unknown to the plaintiff, however, the bank had refused to cash the note unless it was drawn payable without "discount." The agent had therefore inserted the words "or discount" into the note prior to discounting it to the bank. When the note was not paid at maturity, the plaintiff took the note back from the bank and sued on it. The defendant, naturally, asserted the defense of discharge resulting from the alteration. The court seemed somewhat offended at the defendant's position. It said,

The defendant in this case asks this court to decide that he may keep the plaintiff's horse without paying anything for him, because the agent of the plaintiff under an erroneous idea of his rights, made the alteration in question, and which has not, in the least degree affected the defendant. It is not often that a party can perpetrate a fraud by force of the generality of legal rules; the defendant, certainly, cannot in this case.

The court noted that there was no fraudulent intent in this case and that although alteration avoided the note, it nevertheless left the original debt unpaid. Thus, even though the note was ineffective as a result of the alteration, the plaintiff was entitled to receive the agreed value of the horse on the basis of the original debt.

*Hunt v. Grey* shows that one small loophole did exist in the bar erected by the courts against a suit on an altered instrument. A holder of an altered instrument might bring a suit not on the instrument itself but on the underlying obligation for which the instrument was originally given.

Originally, under the common law in England, neither a suit on the

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97. Williston, *supra* note 63, at 177-78.
98. 35 N.J.L. 227 (1871).
99. *Id.* at 234.
100. *Id.*
101. See M. Bigelow, *supra* note 84, at 577 (collected cases); W. Britton, *supra* note 82, § 286, at 1081 (collected cases); I. Edwards, *supra* note 84, § 248, at 192 (collected cases); W. Moore & H. Wilkie, *supra* note 84, § 105, at 321 (collected cases); 2 T. Parsons, *supra* note 82, at
underlying obligation nor a suit on the altered instrument could be maintained. Later, however, the rule changed to allow a suit on the underlying obligation, and no distinction was made as to whether the alteration of the instrument was fraudulent or innocent.

In contrast, under American common law, whether one could sue on the underlying obligation or the altered instrument depended on whether the alteration was made innocently or fraudulently. The common law rule, of course, did not require that the alteration be both fraudulent and material. Thus, a material alteration, whether fraudulent or not, avoided the instrument according to the strict language of the common law rule. Courts in the United States, however, drew a distinction between an alteration made fraudulently and an alteration made innocently. Many courts held that the holder could recover on a materially altered instrument according to its original tenor if the alteration were innocent. These courts, in effect, read into the common law rule on altered instruments the requirement that the instrument be altered both fraudulently as well as materially, thus echoing Judge Buller's concern in Master v. Miller that the intent with which an alteration was made should be considered before automatically granting a discharge on a material alteration. In other jurisdictions, however, courts held that an alteration, whether innocent or fraudulent, avoided the instrument according to the strict common law rule, which did not require fraud. When the alteration was innocently made, these courts nevertheless allowed the holder to recover by suing on the underlying obligation for which the altered instrument was given. If, however, the material alteration was fraudulently made, all courts agreed that the holder could neither sue on the instrument nor on the underlying obligation.

The crack in the bar on suits on the altered instrument, represented by the suit on the underlying obligation, was very narrow. A suit on the underlying obligation was possible only when two conditions were satisfied. First, the suit had to be between parties who had dealt with each
other in a transaction since there would otherwise be no underlying obligation on which to sue. For example, assume A made a note payable to B for purchase of goods. B materially but innocently altered the note, and then negotiated it to C. C could not sue A on the instrument under the strict common law rule, which avoided even an innocently altered instrument, so long as the alteration was material. Nor could he sue A on the underlying obligation, because no obligation existed between A and C. If, however, B had not negotiated the note to C but instead held it until maturity, under the strict common law rule he could not sue A on the instrument, but he could sue A on the underlying obligation which existed between them.

The second condition that reduced the possibility of a suit on the underlying obligation was that the material alteration had to be innocently made. As stated above, if the material alteration was fraudulently made, a holder (such as C in the above hypothetical) could sue neither on the instrument nor on the underlying obligation.

The option of a suit on the underlying obligation therefore proved valuable for the payee who innocently altered an instrument. It gave little comfort, however, to the innocent purchaser (endorsee) for value who took an altered instrument. Because there was no underlying obligation between the endorsee and the maker or drawer of the instrument, the door for such a suit was closed, leaving the latter party's obligation discharged and the endorsee with nothing to show for his purchase of the instrument. Thus, even with the possibility of a suit on an underlying obligation, an endorsee could still suffer the severe penalty resulting from the common law rule—the windfall discharge. Without a doubt, the American common law rule, even as modified by the alternative of a suit on the underlying obligation, was still strongly supported by the original rule's theory that the instrument, once altered, is destroyed and its underlying policy that tampering with an instrument must be punished.

One important element of the common law rule of alteration in America was the spoilation doctrine. This doctrine was the American common law's answer to Judge Buller's concerns in Master v. Miller over

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112. Of course, C could sue B, with whom he did deal. Since B's alteration was innocently made, B would probably still be available and cooperative in a suit against him by C. B could then sue A on the underlying obligation.

113. See supra text accompanying note 111.

114. Even the payee could not sue on the instrument or the underlying obligation if the material alteration was fraudulently made.

115. This result did not occur, of course, if the jurisdiction did not apply the strict common law rule, thus allowing a suit on the instrument assuming the material alteration was innocent. Also, as mentioned in note 112, the endorsee could in any case sue the payee who altered the instrument. If the payee's alteration was innocent, the endorsee might recover because the payee would probably be cooperative; however, if the payee's action was fraudulent, the endorsee might have trouble locating him and enforcing a judgment.

116. See infra text accompanying notes 122-23.
who had made the alteration.\textsuperscript{117} As previously noted, a material alteration of a negotiable instrument by anyone under the common law rule in England discharged a party who did not consent to the alteration.\textsuperscript{118} Thus, the person who altered the instrument need not be the holder; indeed, even a stranger's alteration of the instrument would avoid it just as effectively.

In America, however, the rule developed differently. An alteration by a stranger did not avoid the instrument.\textsuperscript{119} For example, in the previously mentioned case of \textit{Hunt v. Gray},\textsuperscript{120} the plaintiff's agent had inserted the words "or discount" into the note prior to discounting it to the bank. When the note was not paid at maturity, the plaintiff sued on the note, and the defendant asserted alteration as a defense. The court concluded that the alteration of the note by the plaintiff’s agent was outside the agency relationship and that the alteration must be regarded as if done by a stranger. Although the court noted that under the English rule the act of a stranger would avoid an instrument, it applied the American rule that the act of a stranger could not invalidate the instrument.\textsuperscript{121}

Alteration by a stranger under the American common law was usually called a "spoilation" which would not avoid the instrument.\textsuperscript{122} Thus, under the American "doctrine of spoilation," the holder of an instrument altered by a stranger could still enforce the instrument for the original tenor.\textsuperscript{123} As will be explained later, the elimination of this doctrine under the N.I.L. and its later reemergence under the U.C.C. helps explain the drafter's meaning of "the holder" in section 3-407(2)(a) and provides support for the standard interpretation of that phrase.

Examination of the American common law rule on alteration suggests, as did the examination of the English common law rule, that the windfall discharge of section 3-407 is not a result of the language used by the U.C.C. drafters. Rather, the windfall discharge, rooted in the common law rule of England, was incorporated in the American common law rule long before the U.C.C. was drafted. As suggested earlier, the history of the windfall discharge seems to support the standard interpretation that "the holder," as drafted in section 3-407(2)(a), actually means "a holder." Certainly, the standard interpretation is not incorrect merely because it results in a windfall for the drawer/maker and a loss for an

\begin{itemize}
  \item \textsuperscript{117} See supra note 80 and accompanying text.
  \item \textsuperscript{118} See supra note 82 and accompanying text.
  \item \textsuperscript{119} See cases collected in M. Bigelow, supra note 84, at 581; W. Britton, supra note 82, § 280, at 1061; J. Daniel, supra note 82, § 1373, at 337; I. Edwards, supra note 84, § 245, at 192; W. Moore & H. Wilkie, supra note 84, § 105, at 320; Williston, supra note 61, at 114; Note, supra note 101, at 56; Annot., supra note 83, at 102.
  \item \textsuperscript{120} 35 N.J.L. 227 (1871).
  \item \textsuperscript{121} Id.
  \item \textsuperscript{122} Id. at 234.
  \item \textsuperscript{123} See supra note 119.
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innocent holder, since the very same result occurred under the common law rule both in England and America. In addition, the theory and policy behind the rule, both in England and America, presumably justified the harsh result of the windfall discharge which also accompanies the standard interpretation of the contemporary U.C.C. language.

The American common law rule generally followed the strict English rule. Like the English rule, it refused to give protection to the bona fide purchaser for value who took a materially altered instrument; it continued the windfall discharge; and it reflected the theory and policy which demanded a harsh result. In other ways, however, the American common law rule relaxed the strictness of the English rule by virtue of the spoilation doctrine and the possibility of a suit on the underlying obligation. This early trend toward easing the harshness of the English rule would continue under the N.I.L., with mixed results.

V. THE FIRST CODIFICATION: THE NEGOTIABLE INSTRUMENTS LAW

In 1895, the National Conference of Commissioners on Uniform State Laws instructed a committee to prepare a draft of a statute to make uniform the law of negotiable instruments.124 The Committee, following closely the English Bills of Exchange Act enacted by Parliament in 1882, prepared a statute that was adopted by the National Conference in 1896 as the Uniform Negotiable Instruments Law.125 By 1924, the legislature of every state had adopted the act.126

The provision of this law which was to be the ancestor of U.C.C. subsections 3-407(2) and 3-407(3) was section 124:

Section 124. Alteration of Instrument; effect of.

Where a negotiable instrument is materially altered without the assent of all parties liable thereon, it is avoided except as against a party who has himself made, authorized or assented to the alteration and subsequent endorsers. But when an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor.127

Section 124 affected the American common law rule in three ways. First, it introduced the holder in due course concept into the law of alter-
ation, thus eliminating many of the ill effects of the windfall discharge. Second, it eliminated the doctrine of spoilation. Finally, it codified the strict common law rule which allowed a material but innocent alteration to discharge the obligor.

Certainly the most evident of the three changes brought about by adoption of N.I.L. section 124 was the first, that the discharge resulting from the alteration became a real defense only as to the altered amount.128 No longer was discharge a real defense as to the original amount as it was under the common law. Section 124 made this change by providing that a holder in due course could enforce a materially altered instrument according to its original tenor.129

This change in the common law represented a major break between the rule on alteration and the theory and policy which supported the rule from the beginning. The theory that the identity of the instrument was destroyed and thus could not be enforced was largely abrogated, because the holder in due course could now enforce the instrument for its original tenor despite the alteration. The policy, to prevent and punish tampering, was severely weakened by affording the holder in due course the right to enforce the instrument's original tenor. Indeed, the introduction of holder in due course status changed the rule drastically from the time when an alteration was considered a "criminal forgery"130 and the holder, whether a bona fide purchaser or not, suffered a complete loss.

A second way in which N.I.L. section 124 affected the American common law rule on alteration is that it apparently did away with the spoilation doctrine. As stated earlier, England had never adopted the spoilation doctrine in its common law;131 nor was this American doctrine included in the English Bills of Exchange Act in 1882.132 When the National Conference Committee began to draft a provision on alteration for

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128. Ames, The Negotiable Instruments Law, 14 Harv. L. Rev. 241, 243 (1900). Dean Ames, who was highly critical of the Negotiable Instruments Law, called this change one of the "judicious changes for the better." See also W. Britton, supra note 82, § 285, at 1078; W. Moore & H. Wilkie, supra note 84, § 285, at 1078.

129. The English Bills of Exchange Act had made a similar change in the English common law rule; indeed, the Commissioners who drafted the N.I.L. quoted in their notes the following portion of section 64(1) of the English Act to suggest the similarity and to point out the change in the American rule:

W[here a bill has been materially altered but the alteration is not apparent and the bill is in the hands of a holder in due course, such holder may avail himself of the bill as if it had not been altered and may enforce payment of it according to its original tenor.

The Bills of Exchange Act, 1882, 45 & 46 Vict., ch. 61, § 64(1). The Commissioners' notes, including an explanation of how they were compiled, may be found in F. Beutel, supra note 124, at 110, 177.

130. Gettysburg v. Chisholm, 169 Pa. 564, 568, 32 A. 730, 730 (1895); 1 I. Edwards, supra note 84, at 191; 2 T. Parsons, supra note 63, at 583.

131. See supra note 82 and accompanying text.

132. The remaining portion of § 64(1) of the English Bills of Exchange Act not quoted in note 129 supra is as follows: "Where a bill or acceptance is materially altered without the assent of all parties liable on the bill, the bill is avoided except as against a party who has himself made, authorized or assented to the alteration, and subsequent indorsers." The Bills of Exchange Act, 1882, 45 & 46 Vict., ch. 61, § 64(1).
the N.I.L., it relied very heavily on section 64 of the English Bills of Exchange Act and did away with the American doctrine of spoilation.\footnote{Ames, The Negotiable Instruments Law—Necessary Amendments, 16 Harv. L. Rev. 255, 260 (1903). \textsuperscript{133} The abrogation of the American doctrine of spoilation was apparently not inadvertent, but an attempt to make uniform the laws of England and the United States. J. Brannan, The Negotiable Instruments Law Annotated 218 (2d ed. 1911); Farrell, The Negotiable Instruments Law: An Answer to Dean Ames's Latest Criticisms, 5 The Brief 15 (1904); McKeehan, The Negotiable Instruments Law (A Review of the Ames-Brewster Controversy), 50 Am. Law Reg. O.S. 561, 582 (3d paper 1902).} Although some courts continued applying the American doctrine of spoilation even after adoption of the N.I.L.,\footnote{See, e.g., Jeffrey v. Rosenfeld, 179 Mass. 506, 61 N.E. 49 (1901); see also W. Britton, supra note 82, § 280, at 1061 (collected cases); W. Moore & H. Wilkie, supra note 84, § 105, at 318 n.6 (collected cases).} most authorities agreed that N.I.L. section 124 abrogated the doctrine and substituted the English rule.\footnote{F. Beutel, supra note 124, at 1197; W. Britton, supra note 82, § 280, at 1061; W. Moore & H. Wilkie, supra note 84, § 105, at 318 n.6; McKeehan, supra note 133, at 581.\textsuperscript{135} Ames, supra note 133.}

Of the three ways in which the common law rule on alteration was changed by the N.I.L., loss of the spoilation doctrine perhaps caused the most complaints. Harvard Law School’s Dean James Bar Ames, critiquing the N.I.L.,\footnote{United States v. Spalding, 27 F. Cas. 1278, 1279 (C.C.R.I. 1822) (No. 16,365).\textsuperscript{136} Ames, supra note 133.} quoted Justice Story’s famous criticism of the old English rule:

A doctrine (i.e., the English rule allowing a stranger to bring about a discharge on an altered instrument) so repugnant to common sense and justice, which inflicts on an innocent party all the losses occasioned by mistake, by accident, by the wrongful acts of third persons, or by the providence of Heaven ought to have the unequivocal support of unbroken authority, before a court of law is bound to surrender its judgment to what deserves no better name than a technical quibble.\footnote{See Mack, Some Suggestions on the Proposal to Enact the “Uniform Negotiable Instruments Law” in Illinois, 1 Nw. U.L. Rev. 592, 605 (1907); Turner, Revision of the Negotiable Instruments Law, 38 Yale L.J. 25, 51 (1928); Vernier, Amendments to the Negotiable Instruments Law, 24 Ill. L. Rev. 150, 166 (1929).} Dean Ames recommended that section 124 “should be amended by adding after the word ‘altered’ in the first line the words ‘by the holder,’” in order to reinstate the American doctrine of spoilation.\footnote{Three states that adopted the N.I.L., Illinois, South Dakota, and West Virginia, nevertheless retained the spoilation doctrine by altering section 124. F. Beutel, supra note 124, at 177.} Others also suggested the same change.\footnote{Ames, supra note 133.} Dean Ames’ proposed amendment, however, was never made.\footnote{Ames, supra note 133.}

Unlike the introduction of the holder in due course concept, abolition of the doctrine of spoilation by the N.I.L. contributed to the harsh results called for by the theory and policy of the common law rule. It naturally enlarged the pool of persons who could make an alteration that would discharge a party on the instrument, thus increasing the likelihood of a windfall discharge.


\textsuperscript{134} See, e.g., Jeffrey v. Rosenfeld, 179 Mass. 506, 61 N.E. 49 (1901); see also W. Britton, supra note 82, § 280, at 1061 (collected cases); W. Moore & H. Wilkie, supra note 84, § 105, at 318 n.6 (collected cases).

\textsuperscript{135} F. Beutel, supra note 124, at 1197; W. Britton, supra note 82, § 280, at 1061; W. Moore & H. Wilkie, supra note 84, § 105, at 318 n.6; McKeehan, supra note 133, at 581.

\textsuperscript{136} Ames, supra note 133.

\textsuperscript{137} United States v. Spalding, 27 F. Cas. 1278, 1279 (C.C.R.I. 1822) (No. 16,365).

\textsuperscript{138} Ames, supra note 133, at 261.

\textsuperscript{139} See Mack, Some Suggestions on the Proposal to Enact the “Uniform Negotiable Instruments Law” in Illinois, 1 Nw. U.L. Rev. 592, 605 (1907); Turner, Revision of the Negotiable Instruments Law, 38 Yale L.J. 25, 51 (1928); Vernier, Amendments to the Negotiable Instruments Law, 24 Ill. L. Rev. 150, 166 (1929).

\textsuperscript{140} Three states that adopted the N.I.L., Illinois, South Dakota, and West Virginia, nevertheless retained the spoilation doctrine by altering section 124. F. Beutel, supra note 124, at 177.
A third way in which N.I.L. section 124 affected the prior law was that it codified the strict common law rule that provided for discharge when a negotiable instrument was materially altered. Like the strict common law rule, section 124 made no distinction as to whether the alteration was fraudulently or innocently made; any material alteration under the N.I.L. discharged all parties who had not assented to the change.

Codification of the strict common law rule, of course, changed the law in those states that had previously allowed a discharge only when the alteration was both material and fraudulent. After passage of the N.I.L., no recovery on the altered instrument could be maintained, since section 124 clearly provided that the instrument was avoided upon any material alteration. Nevertheless, these states could choose to follow other states that, under pre-N.I.L. law, had barred a suit on a materially altered instrument but allowed the holder to recover on the underlying obligation when the alteration was innocent and not fraudulent and the parties had dealt with each other in the transaction. Under the N.I.L. as well as the common law rule, if the alteration was both fraudulent and material, no court would allow a holder to recover on either the instrument or the underlying obligation.

This codification of the strict common law rule caused some complaints. Dean Ames, for example, in his criticism of section 124 stated, "[I]t would be advisable also to insert before 'materially' in the first line the words 'fraudulently and.' " Others echoed his criticism. No such amendment, however, was made.

Section 124's codification of the strict common law rule, like the abolition of the spoilation doctrine, contributed to the harsh results called for by the theory and policy of the common law rule. By requiring that an alteration be merely material as a condition of discharge, it increased the likelihood that a windfall discharge might result. For the same reason discussed earlier, the possibility of a suit on the underlying obligation did little to help an endorsee of an instrument, although it certainly may have proved valuable to a payee.

The three changes that the N.I.L. made to the American common law rule on alteration caused that rule to move in opposite directions at the same time. The introduction of the holder in due course concept

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141. See supra note 104 and accompanying text.
142. See supra text accompanying notes 105-06.
143. F. BEUTEL, supra note 124, at 1198; W. BRITTON, supra note 82, § 286, at 1082; Note, supra note 101, at 58.
144. See supra note 143.
145. See supra note 111 and accompanying text.
146. Ames, supra note 133, at 261.
147. See supra note 139.
148. Illinois, however, adopted its version of section 124 with the words "fraudulent or." F. BEUTEL, supra note 124, at 177.
moved the rule away from the theory and policy which had called for the harsh treatment of a holder, and it certainly decreased the possibility of a windfall discharge. The abolition of the spoilation doctrine and the codification of the strict common law rule, however, squarely supported the original theory and policy (at least when no holder in due course was involved) and certainly increased the possibility of a windfall discharge.

VI. THE SECOND CODIFICATION: THE UNIFORM COMMERCIAL CODE

In 1951, the American Law Institute and the National Conference of Commissioners on Uniform State Laws promulgated the first official text of the Uniform Commercial Code.149 Section 3-407 of the U.C.C. stated the modern rule on alteration.

Of the three ways in which the N.I.L.’s section 124 affected the common law rule, only one was incorporated into the U.C.C.: the introduction of the holder in due course concept to the rule on alteration, which, as noted previously, undermined the theory and policy of the common law rule and made a windfall discharge less likely. The remaining two changes, the abolition of the spoilation doctrine and the codification of the strict common law rule, both of which reinforced the theory and policy of the common law rule, were erased by section 3-407 of the U.C.C.

The U.C.C. retained the rule of the N.I.L. that alteration was a real defense only as to the altered amount. Under the U.C.C., a holder in due course could thus enforce an altered instrument for its original tenor.150 This rule eliminated most of the ill effects of section 3-407(2)(a)’s discharge provision. Only those non-holders in due course who could not gain holder in due course protection under the shelter provision risked facing the windfall discharge.

The U.C.C. did, however, restore the spoilation doctrine by adding the phrase “by the holder,” as suggested by Dean Ames and others in criticism of the N.I.L.’s abolition of the doctrine. Official comment 3 to section 3-407 states that subsection (2) modifies the rigorous rule of N.I.L. section 124 by providing that a material alteration does not discharge any party unless it is made by the holder.151 It specifically states, “Spoilation by any meddling stranger does not affect the rights of the holder.”152 Thus, the old American doctrine of spoilation, abandoned by the N.I.L., was revived under the U.C.C. in the manner suggested some

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149. White & Summers, supra note 17, at 1; Schnader, A Short History of the Preparation and Enactment of the Uniform Commercial Code, 22 U. MIAMI L. REV. 1 (1967).
150. U.C.C. § 3-407(3) (1977) and introductory clause of § 3-407(2).
152. Id.
four decades earlier.\textsuperscript{153}

By reintroducing the spoilation doctrine, the U.C.C. took away the support the N.I.L. had given to the theory and policy of the common law rule by adopting its abolition. The U.C.C., by reviving the doctrine, reduced the pool of parties who could bring about a discharge, thus making a windfall discharge even less likely and giving little support for the old theory and policy, which called for discharge.

The only other change made in the N.I.L. by the U.C.C. was a change that was first suggested by Dean Ames\textsuperscript{154} and then echoed by others.\textsuperscript{155} Section 3-407(2)(a) added the words "both fraudulent" so that an alteration under the U.C.C. had to be both fraudulent and material in order to bring about a discharge.\textsuperscript{156} Although some state courts had read "fraudulent" into the common law rule prior to adoption of the N.I.L., both the strict common law rule and the N.I.L. required only that an alteration be material before it yielded a discharge.\textsuperscript{157}

By requiring that an alteration must be fraudulent as well as material before a discharge will occur, the U.C.C. again widened the gap between the rule on alteration and the theory and policy that supported the original rule. The requirement of a fraudulent alteration, like the N.I.L.'s introduction of holder in due course status and the U.C.C.'s reintroduction of the spoilation doctrine, expanded the holder's opportunity to sue on an altered instrument. Under the strict common law rule, a bona fide purchaser for value could not sue at all on a materially altered instrument, and under the N.I.L., a non-holder in due course could not sue at all on a materially altered instrument. In contrast, under the U.C.C., even a non-holder in due course can sue on a materially altered instrument as long as it is not fraudulently altered. Since a holder's chance of suing on an altered instrument under the U.C.C. is thus increased, the likelihood of a windfall discharge is accordingly decreased.

The U.C.C. thus retained that part of the N.I.L. under which the rule of alteration shifted away from the theory and policy underlying the original rule: the holder in due course concept. It changed those aspects of the N.I.L. which followed from the original theory and policy: abolition of the spoilation doctrine and codification of the strict common law rule. The net effect of the U.C.C. was to separate, more completely than ever before, the modern rule on alteration from the theory and policy that supported the old common law rule. The possibility of discharge, windfall or otherwise, was less likely under the U.C.C. than it had ever been before.

\textsuperscript{153} See supra text accompanying note 136.
\textsuperscript{154} Ames, supra note 135, at 261.
\textsuperscript{155} See supra note 139.
\textsuperscript{156} U.C.C. § 3-407 comments 3(b), (d) (1977).
\textsuperscript{157} See supra notes 104 & 141 and accompanying text.
VII. LEGISLATIVE HISTORY OF U.C.C. SECTION 3-407

The drafting history of section 3-407 has been decidedly unexciting. Since the official text of the U.C.C. was promulgated in 1951, there have been no changes to sections 3-407 and no state variations.158

The New York Law Revision Commission studied Article 3 and section 3-407 during its examination of the U.C.C. from 1953 through 1956.159 Despite the criticism leveled at the U.C.C., and the New York Law Revision Commission’s final recommendation that it should not be enacted in New York without revision, section 3-407 came out not only unscarred but almost unmentioned.160

The law firm of Milbank, Tweed, Hoke and Hadley, attorneys for the Chase National Bank of the City of New York, studied Article 3 and concluded that it should not replace the N.I.L.161 In its memorandum, filed with the New York Law Revision Commission, section 3-407 was not mentioned.162 In reply, Professor Arthur E. Sutherland of Harvard Law School, Chairman of the Committee on Article 3, wrote that he assumed the sections not expressly criticized in the law firm’s memorandum were unobjectionable.163 He therefore made no attempt to defend section 3-407. Nor did Professor Soia Mentschikoff, in her reply to the law firm’s memorandum, mention section 3-407, apparently for the same reason.164

The first analysis of section 3-407, prepared under the direction of the Law Revision Commission, soon followed. Professor Bertram F. Willcox of Cornell University Law School examined section 3-407 in relation to the present New York law.165 He suggested that 3-407(2)(a)’s rule, that an alteration does not result in discharge unless made “by the holder,” worked no change in New York. He reported that New York had apparently continued to apply its old common law rule, including the doctrine of spoilation,166 even though limiting words like “by the holder” were lacking in New York’s version of N.I.L. section 124.167 He noted that U.C.C. section 3-407(2)(a) had added those limiting words.168

162. See id. at 208.
163. Id. at 240.
164. Id. at 255.
166. New York was one of several jurisdictions that continued to apply the spoilation doctrine even after adoption of the N.I.L. See supra note 134 and accompanying text.
168. Id.
Willcox pointed out that section 3-407(2)(b) would, however, change prior New York law since a non-fraudulent material alteration would no longer trigger a discharge.169

In 1956, when the New York Law Revision Commission recommended changes in the 1952 official text, no changes to section 3-407 were suggested. Although the Commission recommended changes for many other sections, section 3-407 generated the simple comment, “This section was approved.”170

The drafting history of the U.C.C. ordinarily begins with the 1952 official text of the Code, because prior drafts were not approved by the American Law Institute of the National Conference of Commissioners on Uniform State Laws.171 Nevertheless, an examination of prior drafts beginning in 1949, when the first integrated draft of the Code appeared, sometimes helps in the interpretation of the final revisions of the Code.172 In the case of section 3-407, however, an examination of prior drafts reflects only the lack of controversy over the section, already shown by post-1952 legislative history.

In the May 1949 draft of the Code, the text of what was to become section 3-407 differed only slightly from what it is today.173 The words “by the holder” appeared in the 1949 draft and were never revised. By the time the Spring 1951 text edition174 and the November 1951 final text edition175 appeared, the language was exactly as it was to appear in the 1952 official text.

Perhaps the lack of controversy over section 3-407 and the resulting lack of information to be gleaned from its legislative history may be ex-

169. Id.
171. See 6 W. WILLIER, F. HART & R. DISIDERIO, supra note 158, at 1-3.
172. This approach may not be a valid tool for interpreting U.C.C. provisions. Section 1-103(3)(g) of the 1952 edition of the Code provided that “[p]rior drafts of texts and comments may not be used to ascertain legislative intent.” The explanation for this provision was that “[f]requently matters have been omitted as being implicit without statement and language has been changed or added solely for clarity. The only safe guide to intent lies in the final text and comments.” U.C.C. § 1-103(3)(g) comment (1952). Section 1-103(3)(g), however, was deleted in the 1957 edition of the Code at the suggestion of the New York Law Revision Commission. The stated reason for the deletion was that changes to the 1952 edition were clearly legitimate history. This reasoning may or may not suggest that pre-1952 history may be used to determine intent. White and Summers list prior drafts as an aid to interpretation and construction of the Code, but warn that “lawyers cannot base reliable inferences as to intended meaning of enacted text on changes made from prior versions of that text.” WHITE & SUMMERS, supra note 17, at 11.
173. U.C.C. § 3-406 (1949). Subsection (2)(a) of the 1949 draft differs from the modern version by including the word “otherwise” as follows: “[A]lteration by the holder which is both fraudulent and material discharges any party whose contract is thereby changed unless that party assents or is otherwise precluded from asserting the defense.” Id. Subsection (3) of the 1949 draft differs from the modern version by including “before he takes” as follows: “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 before he takes, he may enforce it as completed.” Id. This 1949 draft was published for study purposes and was not recommended for adoption by the states. 6 W. WILLIER, F. HART & R. DISIDERIO, supra note 158, at 1-3.
174. U.C.C. § 3-407 (Spring 1951).
175. U.C.C. § 3-407 (November 1951).
plained by the fact that section 3-407 actually received its closest scrutiny some four decades before the first integrated draft of the U.C.C. appeared in 1949. This occurred during the famous Ames-Brewster controversy which included N.I.L. section 124, the ancestor of U.C.C. section 3-407. As noted previously, N.I.L. section 124 was praised in that controversy for its incorporation of the holder in due course concept into the rule on alteration, but it came under fire by Dean Ames and others because of its apparent abolition of the doctrine of spoilation and its failure to require that the alteration be fraudulent as well as material. The drafters of the U.C.C. retained in new section 3-407 the holder in due course concept, and included “by the holder” and “and fraudulently” just as Ames had proposed in order to remedy his criticism of section 124. Hence, the articles documenting the Ames-Brewster controversy should be considered as valid legislative history for section 3-407.

The Ames-Brewster controversy clearly suggests the significance of the phrase, “by the holder,” in subsection (2)(a): it revived the spoilation doctrine, which had been dropped by the N.I.L. drafters in reliance on the English Bill of Exchange Act. Dean Ames proposed this exact phrase to restore the spoilation doctrine, and the drafters of the U.C.C., relying on the Ames-Brewster controversy as legislative history, apparently incorporated both Ames’ suggestion and its rationale. Thus, based on this legislative history, the phrase does not answer the interpretive problem raised by Professor Steinheimer when he asked, “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?” The phrase was intended only to make it definite, as official comment 3a clearly confirms in light of this legislative history, that the spoilation doctrine was back, this time to stay.

VIII. A U.C.C. Case

No appellate case decided under the U.C.C. has yet resulted in a windfall discharge. Although cases involving altered instruments still frequently reach the appellate level as they did under the common law and the N.I.L., an alteration under the U.C.C. is usually found to be either immaterial, not fraudulent, or perhaps not made by the holder, so


177. See supra note 128 and text accompanying notes 136 & 146.

178. See supra note 51.

179. See supra note 10.

that even a non-holder in due course may enforce the instrument for the original tenor despite the alteration.\textsuperscript{181} Without a discharge, of course, no windfall discharge can result.

One lower court U.C.C. decision, however, includes all the elements of the classic windfall discharge case. In \textit{First Pennsylvania Bank & Trust Co. v. Kritzberger},\textsuperscript{182} a representative of Greater Premiums Food Company, Inc. (Company) persuaded the defendants to sign a note\textsuperscript{183} payable to the Company in return for the immediate delivery of a food freezer and future deliveries of food. Since neither of the parties was sure of the cost of the food at the time, the spaces in the note for the amount were not filled in. The Company, however, later completed those blanks with an amount much larger than the defendants had told the representative they would be able to pay. The Company then negotiated the note to the First Pennsylvania Bank & Trust Co. (Bank). When the Bank informed the defendants of the installment amounts due, they responded that they had never given authority for an amount that large and refused to pay. The Bank sued. Since the note contained a confession of judgment clause, the Bank easily obtained a judgment against the defendants, who then petitioned to reopen the case to consider their defense.

The court first established that fraud was apparently perpetrated on the defendants, justifying the opening of the judgment and the submission of the issues to the jury. In addition, it found a second reason for opening the judgment. Citing U.C.C. section 3-407, the court held that the Company's completion of the blanks with an amount greater than that authorized was a material alteration, and that the alteration had been made fraudulently. Furthermore, since the Bank under section 3-407(3) and section 3-307(3) had not established it was a holder in due course, the court held that the Bank took the note subject to the defendant's defense, a discharge under section 3-407(2)(a). Therefore, since the court found that the defendants had a meritorious defense, the court ordered the judgment reopened.

With the case reopened, the Bank had the opportunity to establish it was a holder in due course. If it could, it would take free of the defense of discharge and could enforce the instrument against the defendants for the completed amount. If not, however, a windfall discharge would have occurred, with the defendants in possession of the food freezer and perhaps several months' worth of food, and the Bank unable to assert the

\begin{itemize}
  \item \textsuperscript{181} See Annot., 88 A.L.R. 3d 905 (1978)(collected cases).
  \item \textsuperscript{183} The opinion is confusing as to whether the signed writing was a negotiable promissory note under U.C.C. § 3-104(1) and (2)(d) or whether it was a non-negotiable installment sales contract. The opinion initially refers to the writing as a note but later shifts to the term "installment sales contract." It refers to § 3-407 without deciding whether the writing was a negotiable instrument, but also refers to U.C.C. § 9-206(1) as if the writing were not a negotiable instrument. 32 Pa. D. & C.2d at 620, 623.
\end{itemize}
note against the defendants for any amount.\textsuperscript{184}

In all likelihood, the Bank would have been able to prove holder in due course status in this case. After all, the Owens case\textsuperscript{185} was not yet available to support any judicial consumer protection, and the F.T.C. regulations, which might also have applied, were over a decade and a half yet in the future. If this case had arisen later, either Owens or the F.T.C. regulations might well have applied to bring about the windfall discharge by denying holder in due course status to the Bank. Certainly all the elements for a windfall discharge were present.

\textbf{IX. ABOLITION OF HOLDER IN DUE COURSE STATUS UNDER THE F.T.C. REGULATIONS AND THE PROPOSED UNIFORM NEW PAYMENTS CODE}

As noted earlier,\textsuperscript{186} the Federal Trade Commission's regulations create a large class of noteholders who cannot be holders in due course. If one cannot be a holder in due course of notes so affected by the F.T.C. regulations, no subsequent holder can obtain holder in due course status under the shelter provision of U.C.C. section 3-201(1). Therefore, a holder of such a note will never be able to seek the protection of section 3-407(3) for the holder in due course when a previous holder makes a material and fraudulent alteration. As a result, the F.T.C. regulations may potentially bring about windfall discharges as frequently as did the English common law rule, under which alteration was a real defense even as to the original tenor. Indeed, under the F.T.C. regulations, a material and fraudulent alteration by the holder (assuming the standard interpretation) becomes in effect again a real defense, as it was under the English common law rule, since it can be asserted against any noteholder (assuming the F.T.C. regulations apply) under section 3-407(2)(a) to cause a complete discharge of a maker.\textsuperscript{187}

The effect of the proposed Uniform New Payments Code\textsuperscript{188}

\textsuperscript{184} Of course, the Bank could proceed against Greater Premium Food Company, Inc., unless it took the note without recourse. Although the typical response of the fraudulent alterer might be to run for places unknown or to become suddenly judgment proof, the facts indicate that the Company was probably still available for suit. The Company's representative, who persuaded the defendants to sign the note, probably vanished like the typical fraudulent alterer.


\textsuperscript{186} See supra text accompanying notes 28-30.

\textsuperscript{187} Section 3-407(2)(a)'s discharge provision may not apply to a note which complies with F.T.C. regulations. Although confusion exists as to why the F.T.C. language has the particular effect it has, see supra note 30, the theory that the language makes payment of the note conditional under § 3-104(1)(b) and thus non-negotiable pushes the note that complies with F.T.C. regulations outside the U.C.C. and § 3-407(2)(a)'s discharge provisions. See 4 W. Hawkland & L. Lawrence, supra note 30, § 3-302:09, at 386; White & Summers, supra note 17, at 1138. Even if the note complying with F.T.C. regulations thus becomes a simple contract, its assignee faces similar discharge consequences under contract law rules on alterations. See Restatement (Second) of Contracts § 286 (1981).

\textsuperscript{188} All references to sections of the Uniform New Payments Code (U.N.P.C.) are to Permanent Editorial Board Draft No. 3, June 2, 1983. This draft, of course, has never been promulgated or approved by the "3-4-8" Committee or the Permanent Editorial Board.
(U.N.P.C.) on holder in due course status as to a consumer check\textsuperscript{189} is less well known than that of the F.T.C. regulations as to certain notes. As stated earlier,\textsuperscript{190} the “3-4-8” Committee, in drafting the U.N.P.C., considered abolition of holder in due course status for transferees of consumer checks.\textsuperscript{191}

As worded in Permanent Editorial Board Draft No. 3, the U.N.P.C. applied only to “any orders payable by or at, or transmitted by or to an account institution.”\textsuperscript{192} Thus, all checks and many drafts were within the scope of the U.N.P.C.; to that extent, they were excluded from the scope of article 3 of the U.C.C.\textsuperscript{193} Promissory notes and any drafts not within the scope of the U.N.P.C. remained subject to article 3 of the U.C.C.\textsuperscript{194}

Since U.C.C. section 3-407’s provisions on alteration would no longer apply to checks and drafts within the scope of the U.N.P.C., a new provision for alteration had to be included in the new code. Thus, section 156 of the U.N.P.C. provided that “[a] funds claimant who has fraudulently and materially altered an order discharges the obligation of any party on the order whose contract is changed unless the party assents to the alteration or is precluded from asserting the discharge defense.”\textsuperscript{195}

As suggested in its accompanying comment, this section follows U.C.C. section 3-407(2)(a). One difference, however, is quite noticeable. Although the term “funds claimant”\textsuperscript{196} in section 156 is the counterpart of “holder” under the U.C.C.,\textsuperscript{197} the U.N.P.C. introduces “funds claimant” with the article “a” rather than “the,” which precedes “holder” in U.C.C. section 3-407(2)(a). This change in the U.N.P.C. supports the standard interpretation that “the” means “a” in U.C.C. section 3-407(2)(a).

U.N.P.C. section 156 gives the drawer a complete discharge when a material and fraudulent alteration is made by a “funds claimant.” Section 103(3) of the U.N.P.C. prevents a funds claimant from gaining due

\textsuperscript{189} The U.N.P.C. does not use the term “consumer check,” but rather refers to the check of the “consumer drawer,” which is not subject to due course rights under U.N.P.C. § 103(3). U.N.P.C. § 52(1) defines a consumer drawer as “an individual who is authorized to initiate orders against a consumer account.” U.N.P.C. § 50(12) defines a consumer account as an “account established with an account institution in the name of one or more individuals, unless such individuals have represented in writing to the account institution that the account is not to be used primarily for personal, family or household purposes.”

\textsuperscript{190} See supra note 31 and accompanying text.

\textsuperscript{191} Benfield, supra note 31, at 12; Brandel & Soloway, supra note 16, at 1363; H. Scott, Memorandum to National Conference of Commissioners on Uniform State Laws 16 (June 15, 1983); U.N.P.C. § 103(3). Comment 3 to U.N.P.C. § 103 explores the justification for the abolition of holder in due course status for the transferee of a consumer check.

\textsuperscript{192} U.N.P.C. § 2. Section 53(1) defines an account institution as “any person which in the ordinary course of its business maintains accounts for its customers.”

\textsuperscript{193} U.N.P.C. § 2 & comment; H. Scott, supra note 191, at 4.

\textsuperscript{194} U.N.P.C. § 2 & comment; H. Scott, supra note 191, at 4.

\textsuperscript{195} U.N.P.C. § 156.

\textsuperscript{196} “Funds claimant” is defined in U.N.P.C. § 52(11).

\textsuperscript{197} See H. Scott, supra note 191, at 9.
course rights on a consumer check even if he has taken for value, in good faith, and without notice. Since a funds claimant without due course rights takes subject to all claims and defenses, a discharge acquired by the drawer under section 156 as a result of alteration may therefore be asserted against the funds claimant. Thus, a funds claimant (i.e., a holder) of a check written on a consumer account cannot take free of the defense of discharge acquired by a drawer under section 156.

Like the F.T.C. regulations, the U.N.P.C. would create a large class of check holders who cannot acquire due course rights, or, in U.C.C. terms, holder in due course status. In addition, as with the consumer note under the F.T.C. regulations, if a funds claimant cannot acquire due course rights on a consumer check under the U.N.P.C., a subsequent funds claimant cannot acquire due course rights from a prior transferor under U.N.P.C. section 106, the equivalent of the U.C.C.'s shelter provision. Therefore, under the U.N.P.C., a funds claimant on a consumer check will never be able to acquire due course rights in order to take free of a material and fraudulent alteration by a prior funds claimant. As a result, the U.N.P.C. has the potential of bringing about windfall discharges as frequently as did the English common law rule, under which alteration was a real defense even as to the original tenor. Indeed, just as under the F.T.C. regulations, a material and fraudulent alteration by a funds claimant under U.N.P.C. section 156 is a real defense, as it was under the old English common law rule, since it can be asserted against any funds claimant on a consumer check to bring about a complete discharge of the drawer.

The proposed abolition of holder in due course status for consumer checks, however, did not survive its draft form. Beginning in November of 1983, the "3-4-8" Committee, the Permanent Editorial Board, and the National Conference of Commissioners on Uniform State Laws, together with the American Law Institute, decided to eliminate the special consumer provisions in any future draft, thus excluding the limitation on due course rights under U.N.P.C. section 103.

Although the special consumer provisions of the U.N.P.C. were eliminated, the idea of abolishing holder in due course status as to a consumer check has been seriously considered. Strong policy arguments have been made and published in its support, and it has received at

198. U.N.P.C. § 104(1) generally allows a funds claimant to acquire due course rights if he takes for value, in good faith, and without notice. A funds claimant with due course rights, just as a holder in due course under the U.C.C., ordinarily takes free of claims and most defenses under U.N.P.C. § 104(4).
199. U.N.P.C. § 103(3).
201. U.N.P.C. § 103 comment 3.
least some favorable comment. Although the day may not yet have arrived for abolition of holder in due course status as to a consumer check, it may not be far in the future.

If holder in due course status were ever abolished as to the holder of a consumer check as proposed under the U.N.P.C., the potential for windfall discharge would increase exponentially, considering the tremendous number of checks in circulation. In net effect, the rule on alteration for some notes and many checks would be altered to its original form prior to the codification of the N.I.L. and the introduction of holder in due course status, a change probably not contemplated by the F.T.C. or the "3-4-8" Committee.

IX. CONCLUSION

Who is the section 3-407(2)(a) holder who, by his material and fraudulent alteration of a negotiable instrument, will discharge a drawer, maker or other party on the instrument at the expense of a subsequent holder? Is he "the" holder at the time the claim is made and the defense asserted, or is he just "a" holder who previously held the instrument? Section 3-407(2)(a) does not, by itself, answer that question.

To be sure, legal writers in the past have attempted to interpret the phrase "by the holder" in section 3-407(2)(a) so as to answer this question, but the results have always been unsatisfactory. The apparent reason is that the phrase "by the holder" was never intended to answer that question. The history of the spoilation doctrine yields the conclusion that the wording of the phrase "by the holder" in U.C.C. section 3-407(2)(a) was specifically intended to reinstate the spoilation doctrine. The phrase "by the holder" was never intended to answer questions other than those concerning the spoilation doctrine. Thus, it is unfair to criticize the standard interpretation simply because it forces one to read "the holder" as "a holder," contrary to the express language of section 3-407(2)(a). The drafters deliberately used the words "the holder," but only to revive the spoilation doctrine and not to resolve whether only "the holder," as opposed to "a holder," may generate a discharge by altering an instrument.

If the phrase "by the holder" does not determine the holder that will bring about a discharge under section 3-407(2)(a), how can that question be answered? The only source that has ever resolved the question is the common law rule that first took root in England and then was transplanted to America. Early case law in England and America shows that "a" holder (i.e., any holder) who altered an instrument could in fact discharge a party on the instrument so that even a subsequent holder could

not enforce it. No case indicates that only "the" holder at the time the claim is made and the defense asserted could bring about a discharge. Indeed, the holder in due course concept was apparently introduced by the N.I.L. specifically to ameliorate some of the ill effects which "a" holder could cause a subsequent party.

The common law rule thus supports the standard interpretation since both would allow "a" holder to bring about a discharge. No evidence exists today to show that the common law rule's intended use of "a" holder has in any way changed. N.I.L. section 124 certainly has no language to indicate that "a" holder cannot bring about a discharge. If the phrase "by the holder" relates, as suggested, only to the spoilation doctrine, U.C.C. section 3-407 also has no language to indicate that "a" holder cannot bring about a discharge. Since the U.C.C. is not a comprehensive codification in that its provisions may be supplemented by the common law,\(^2\) the answer to the question of what "holder" can cause a discharge under section 3-407(2)(a) is "a" holder or any holder, just as was true under the common law rule. The standard interpretation is consistent with this conclusion.

The common law rule further suggests that it is unfair to criticize the standard interpretation merely because it brings about the windfall discharge. The common law rule also triggered the windfall discharge. No language in the N.I.L. or the U.C.C. suggests that the windfall discharge has been eliminated, unless the instrument is held by a holder in due course or one who has the rights of a holder in due course under the shelter provision of section 3-201(1). Thus, the windfall discharge still exists to the extent that it has not been abolished by the holder in due course concept. If the standard interpretation brings about a windfall discharge, that result is entirely in line with section 3-407(2) as supplemented by the common law rule.

Assuming that the standard interpretation is correct, we must live with the windfall discharge to the extent that it still exists. Although the holder in due course concept formerly minimized the frequency of the windfall discharge, the present effect of the F.T.C. regulations and the possible future effect of any legislative action similar to the U.N.P.C. indicates that the windfall discharge may once again become common.

The reemergence of the windfall discharge is probably something we should not welcome. The gap between the modern rule under section 3-407 and the theory and policy that supported the strict common law rule suggests why. The theory and policy expounded in the early common law cases shaped the strict common law rule and spawned the windfall

\(^2\) U.C.C. § 1-103 (1977); see also Lawrence, Misconceptions About Article 3 of the Uniform Commercial Code: A Suggested Methodology and Proposed Revisions, 62 N.C.L. REV. 115 passim (1983).
discharge. The modern rule, however, has been modified over time to eliminate the harsh results demanded by the common law theory and policy. Indeed, the trend of the law of alteration over the years has been to allow a subsequent holder of an altered instrument a much better chance of successfully suing on that instrument. If the effects of the F.T.C. regulations and the U.N.P.C. are not considered, alteration is not nearly as serious as it was under the common law. Indeed, the policy of the modern rule, if there is one, seems to be that a holder who materially and fraudulently alters an instrument should be punished, but not at the expense of a subsequent, innocent holder. If this indeed is the policy behind the modern rule, it would seem that the windfall discharge, increasingly likely under the F.T.C. regulations and legislation similar to the U.N.P.C., should be most unwelcome. Instead of punishing just the holder who fraudulently and materially altered the instrument, many entirely innocent holders will be punished—even those who would qualify as holders in due course in the absence of the F.T.C. regulations or the U.N.P.C.

The windfall discharge of section 3-407(2)(a) should be eliminated to avoid its interference with the apparent policy of the U.C.C. of protecting subsequent innocent holders of an instrument materially and fraudulently altered by a previous holder.\(^{204}\) Certainly, the abolition of holder in due course status as to consumer notes and its possible abolition as to consumer checks urge elimination of the windfall discharge.

The windfall discharge may be eliminated either by amendment\(^ {205}\) to section 3-407(2)(a)'s discharge provision or by outright abolition of the discharge by alteration. Eliminating the windfall discharge by amendment may appear more attractive, but it would be more complex and difficult to draft. Abolition of the discharge seems a rather drastic measure in light of discharge's long history in association with alteration, but it may be exactly what is needed.

The purpose of amendment could be twofold: (1) to eliminate the windfall discharge by no longer rewarding the party whose contract has been altered if he has received value in exchange for the instrument and (2) to continue to discourage and punish those who tamper with negotiable instruments. Amendment thus presupposes that section 3-407(2)(a)'s

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\(^{204}\) As an alternative to elimination, the windfall discharge might be avoided by use of a quasi-contract theory, allowing the non-holder in due course, against whom discharge under U.C.C. § 3-407(2)(a) could be asserted, to sue the drawer or maker to prevent unjust enrichment. See generally 1 A. CORBIN, CORBIN ON CONTRACTS § 19 (1963). This alternative, however, is only a makeshift solution in light of the uncertainties surrounding whether a court will allow a quasi-contract theory and whether § 3-407(2)(a) may be supplemented by that theory under § 1-103.

\(^{205}\) Amendment, as I use the term, could be anything short of outright abolition of § 3-407(2)(a)'s discharge provision; the amendment suggested in the text is, I think, midway between § 3-407 as it is now and outright abolition.
discharge provisions will remain, and that only the ill effects of the wind-
fall discharge will be eliminated.

Such an amendment might provide that to the extent a maker or
drawer, otherwise discharged by a fraudulent and material alteration
under section 3-407(2)(a), has received value in exchange for an altered
instrument, his contract should not be discharged as to an innocent, non-
altering holder. Without the requirement that a non-altering holder be a
holder in due course, such an innocent non-holder in due course could,
under the amendment, enforce a fraudulently and materially altered in-
strument so that no windfall discharge would result. The maker or
drawer would have to pay the amount of the instrument to the non-alter-
ing holder to the extent of the value received, and the non-altering holder
could not enforce the contract except to that extent.

Although such an amendment would eliminate the windfall dis-
charge of section 3-407(2)(a) in the above situation, the discharge provi-
sions would remain in effect in two other situations. The first of these
situations would not result in a windfall discharge. The second would
result in a windfall discharge, but not with the usual ill effect.

The first situation would occur when no value is exchanged for the
instrument. To the extent that the maker or drawer whose contract has
been altered has not received value in exchange for the instrument (for
example, as when a thief steals a bearer instrument from a maker or
drawer and then alters it), not even a non-altering holder should be able
to enforce the contract even as to the original tenor.\footnote{206} However, the
maker or drawer would not receive a windfall discharge, since no value
was given in exchange for the instrument.

The second situation involves the holder who fraudulently and ma-
terially altered the instrument. Whether the maker or drawer whose
contract was altered gave value in exchange for the instrument or not,
the holder who fraudulently and materially altered the instrument should
not be able to enforce the instrument. In this situation, a windfall dis-
charge would still occur to the extent the maker or drawer gave value,
but the windfall would be justified because it punishes only the party who
materially and fraudulently altered the instrument. Of course, if no
value were received by the maker or drawer, a discharge would occur but
without the windfall.

An amendment of section 3-407(2)(a) could thus eliminate the worst
effect of the windfall discharge, but retain enough of the discharge provi-
sion to punish those who fraudulently and materially alter negotiable in-
struments. The key, of course, to such an amendment is that the
innocent, non-altering holder, to enforce the materially and fraudulently

\footnote{206. The exception is if the non-altering party were a holder in due course, who could then enforce the contract for the original tenor under § 3-407(3).}
altered instrument, need not be a holder in due course, thus eliminating
the windfall discharge except as to the holder who has materially and
fraudulently altered the instrument. The problem in drafting such an
amendment is describing the non-altering holder who may enforce the
fraudulently and materially altered instrument when value has been
given in exchange. Exactly how much less than a holder in due course he
may be and still be allowed to enforce the instrument presents a real
problem in drafting. Describing the non-alterer as an "innocent" holder
will not be sufficient unless innocence is defined with some certainty.

Surely, if the non-altering holder was in some way involved in the
alteration, and perhaps even if he merely knew of the alteration before he
took the instrument, he should not be allowed to enforce the instrument,
even though he did not actually do the altering. Suppose, however, that
a non-altering holder who was unaware of the alteration just happened to
be a non-holder in due course by reason of some matter unrelated to
alteration, such as receiving notice that a check was overdue under sec-
tion 3-304(2)(c). That might indeed be one case in which the non-alter-
ing holder should be described as "innocent" and permitted to enforce
the materially and fraudulently altered instrument, at least to the extent
of value received by the maker or drawer.

However, if an innocent, non-altering holder may take with notice
of the type specified in section 3-304(2)(c), which is completely unrelated
to alteration, one might conclude that such a holder should be able to
take with notice of other matters, as long as they have nothing to do with
alteration, and still be able to enforce the instrument. That conclusion,
however, would surely be too far-reaching, because under the U.C.C. a
non-holder in due course takes subject to claims and defenses unrelated
to the reason that he is not a holder in due course.\textsuperscript{207} Further, merely
that an alteration occurred should not give a non-holder in due course
the right to take free of notice of claims and defenses other than those
related to alteration, a right not available to the ordinary non-holder in
due course.

Unfortunately, it is difficult to amend section 3-407(2)(a) to specify
the kinds of claims and defenses of which one might have notice, yet still
be considered "innocent," and hence permitted to enforce a materially
and fraudulently altered instrument. Indeed, except for the situation in-
volving section 3-304(2)(c), it is hard to identify another situation in a
U.C.C. context\textsuperscript{208} in which a non-altering, non-holder in due course is an
"innocent" party who should be allowed to enforce a materially and

\textsuperscript{207} \textbf{White} \& \textbf{Summers}, \textit{supra} note 17, at 568.
\textsuperscript{208} Outside the U.C.C. context, two such situations might be identified. First, a non-altering
party may not qualify as a holder in due course merely because of F.T.C. language in a consumer
note. Second, under the proposed U.N.P.C., a non-altering party may not have the rights of a holder
in due course merely because of the existence of a consumer check.
The Holder of U.C.C. Section 3-407(2)(a)

fraudulently altered instrument. Surely, such innocent, non-altering holders exist in other situations, but allowing notice of some claims or defenses unrelated to alteration, but not others, quickly leads to unwanted wrinkles in the fabric of the U.C.C.

Part of the problem in drafting an amendment is that section 3-407(2)(a) imposes a double penalty on any non-holder in due course who seeks to enforce an altered instrument. First, the maker or drawer whose contract has been altered can assert the defense of alteration, to the extent the amount is altered. Second, the maker or drawer whose contract has been altered can assert discharge of the original amount against the non-holder in due course, if the instrument has been materially and fraudulently altered by a holder. Any attempt to draft an amendment that eliminates part of the double penalty in some situations, but retains it entirely in others, would perhaps inevitably lead to unwanted wrinkles. It may indeed be impossible to define exactly when the double penalty should be present and when it should not, without disturbing the fabric of the U.C.C.

However, if the second part of the double penalty, the discharge provision, were eliminated entirely from section 3-407, the windfall discharge and all of its ill effects would be entirely removed, and the fabric of the U.C.C. would remain undisturbed. In other words, abolishing the discharge provision of section 3-407(2)(a), rather than amending that section, may well be the better proposal.

Indeed, although certainly more shocking and drastic, abolishing alteration as a ground for discharge would be a far easier and less complex proposal. Section 3-407(2) and (3) could simply be eliminated, with the result that alteration would still be a defense to the extent of the alteration, but the maker or drawer of the instrument would remain liable for the original amount. Without a doubt, this proposal would abolish the windfall discharge since any holder, altering or non-altering, holder in due course or non-holder in due course, would be able to enforce the instrument according to its original tenor. The defense of alteration would be effective only as to any altered term.

What is shocking about this proposal is that eliminating discharge of the maker or drawer whose contract was altered also eliminates punishment of the holder who materially and fraudulently alters an instrument. This result probably provides the strongest argument against abolition of the discharge provision. Although the maker or drawer could still assert alteration as a defense to the extent of the alteration, he would continue to be liable even to the altering holder for the original tenor.209 Thus, a

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209. The altering holder may have technically breached the warranty of no material alteration. U.C.C. §§ 3-417(1), 4-207(1) (1977). Damages under that warranty, however, would ordinarily be limited to the extent of the alteration. 4 W. HAWKLAND & L. LAWRENCE, supra note 30,
holder may no longer be restrained from making a fraudulent alteration by fear that he later may not enforce the instrument even for the original tenor.

This result, of course, runs contrary to the policy of the common law of England, incorporated into the American common law. In the words of Lord Kenyon in *Master v. Miller*, "[N]o man shall be permitted to take the chance of committing a fraud without running any risk of losing by the event, when it is detected." Complete discharge of the instrument provided a disincentive against alteration under not only the common law, but also the N.I.L. and the U.C.C. Abolition of the discharge provision would, of course, eliminate this ancient disincentive, so that a party would no longer be punished for a fraudulent alteration.

The fear of discharge as a disincentive for alteration sounds good in theory, but whether it actually works is another question. One must surely agree with Professor White that an altering holder will not be deterred by the fact that his actions might discharge a maker or drawer, while he negotiates the altered instrument to a third party for value. In that situation, the innocent third party cannot enforce the instrument against the maker or drawer, thus setting the stage for a windfall discharge. Whether or not section 3-407(2)(a)’s discharge provision provides a real disincentive in any other situation may be questioned in light of the large number of reported cases involving alteration; either people are unaware of the possible discharge resulting from alteration, or they are quite willing to take the risk. In all fairness, however, it is possible that without the disincentive of discharge the number of alteration cases might be even greater. Indeed, without empirical evidence of the effect of the discharge, we will probably never know whether its purpose has ever been fulfilled.

Even if one concedes that the discharge provision may indeed provide some disincentive and that its benefits outweigh its harms, it is still possible to argue that the provision and its potential for causing windfall discharge could be eliminated without loss of all disincentive to the fraudulent alterer. The argument assumes that a person who fraudulently alters a negotiable instrument anticipates a criminal penalty, not the civil penalty of discharge under section 3-407. Indeed, assuming that altering a check for fraudulent purposes is a crime in all states and triggers sufficient punishment, the U.C.C. need not also provide a civil

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211. Although no U.C.C. case mentions discharge as a disincentive, the idea is still around. See 4 W. HAWKLAND & L. LAWRENCE, supra note 30, § 3-407:07, at 624.
212. WHITE & SUMMERS, supra note 17, at 605 n.57.
213. For example, in North Carolina a fraudulent and material alteration of a negotiable instrument may fall within the scope of N.C. GEN. STAT. § 14-100 (1985), a criminal statute dealing with
penalty to deter alteration.

The reason that the U.C.C. provides a penalty for alteration may possibly be explained by the fact that the English common law rule on alteration, which first provided for discharge, developed when the criminal law had not yet separated clearly from the civil law. Rules that are today considered civil in nature often carried punishment or penalties as if they were criminal in nature. The penalty of discharge apparently remained with the rule on alteration after the criminal law had clearly broken away from the civil law, and is today a vestige of the early common law’s lack of clear distinctions between civil and criminal law. If the criminal law will do today what the rule on alteration’s discharge was originally intended to do, the penalty of discharge need no longer remain in U.C.C. section 3-407(2)(a).

Another possible argument against abolishing the discharge provision is that subsequent holders might not be so careful about taking an instrument with a material alteration if they need no longer fear discharge. Surely, however, that would not be the case. Under the present section 3-407(2)(a) rule, even a holder in due course is punished for taking a materially altered instrument, in the sense that he can assert it against the maker or drawer only for the original tenor and not as to any greater amount. If discharge is abolished as a result of alteration, the outcome will be the same. Any party taking an instrument, whether a holder in due course or not, must be concerned about a prior alteration, because he will be able to enforce it against the maker or drawer only for the original tenor, thus losing the difference between the original tenor and the altered amount.

Finally, if discharge were eliminated as an effect of alteration, it appears that the result of alteration cases would not change, at least judging by the outcome of the reported decisions. As noted earlier, no case under the U.C.C. has resulted in a discharge under section 3-407, because the alteration is found not to have been material, fraudulent, or made by a holder. In other words, most courts do not allow alteration to result

obtaining property by false pretenses, as well as N.C. GEN. STAT. § 14-119 (1985), a criminal statute concerning forgery of bank notes, checks, and other securities. Before abolishing the discharge provision of § 3-407, each state should examine its criminal statutes to be certain that the criminal laws indeed provide adequate deterrence against alteration.

214. Although Glanville introduced his treatise with the remark that “some pleas are criminal and some are civil,” that statement bore little relation to the state of law in his time. Indeed, the line between civil law and criminal law in medieval England was anything but certain. See T. PLUCKNETT, A CONCISE HISTORY OF THE COMMON LAW 421 (5th ed. 1956).

215. Cf. U.C.C. §§ 7-208, 7-306 (1977), under which even a fraudulent and material alteration of a document of title does not discharge the issuer’s duty to deliver the goods according to the original terms of the document.

216. This result, of course, assumes no negligence under U.C.C. § 3-406, and that a maker or drawer who issues an instrument gives no warranty against material alterations under U.C.C. §§ 3-417(2) and 4-207(2).

217. See supra note 181 and accompanying text.
in discharge. Indeed, a court will probably not grant a discharge unless it is quite clear that a holder indeed made a material alteration and did so with fraudulent intent. As discussed earlier, only one case has even approached that model.\textsuperscript{218}

Although abolishing the windfall discharge does seem drastic, it would actually complete the alteration rule's evolution, which began when the holder in due course concept was introduced in the N.I.L., or perhaps even earlier when the spoilation doctrine became part of the American common law rule. Both of those innovations moved the rule away from the theory and policy which had originally supported it. Since that time, the gap between the rule and its original theory and policy has continued to widen. With the introduction of the F.T.C. language and with the possible abolition of holder in due course status as to a consumer check under the proposed U.N.P.C., however, the evolution of the rule has regressed for the first time since the U.C.C. was proposed in 1952. If the discharge provision of section 3-407(2)(a) is now abolished, the rule on alteration will return to the evolutionary path it has generally followed over the past several hundred years, toward a more liberalized rule allowing holders to enforce materially and fraudulently altered instruments according to their original tenor.