

ARTICLE

REVISED ARTICLE 3: “[REVISE] IT AGAIN, SAM”

*Sarah Howard Jenkins**

Table of Contents

I. PEB COMMENTARY	886
II. SURETYSHIP – SOME SUBTLE BUT SIGNIFICANT ISSUES	891
A. <i>Accommodation and Accommodated Parties</i>	892
B. <i>Accommodation Party’s Rights Against the Accommodated Party</i>	895
1. <i>Reimbursement</i>	895
2. <i>Subrogation</i>	897
3. <i>Preservation of Recourse</i>	899
C. <i>Recommendation</i>	916
III. OTHER MINOR ADJUSTMENTS	917
A. <i>The Co-Maker’s Rights Clarified</i>	917
B. <i>The Issuer & Remitter: A Neglected Concern</i>	918
IV. CONCLUSION	925

More than fifty years after the initial drafting of Article 3¹ and six years² after the failed attempt to promulgate the Uniform

* Professor of Law, University of Arkansas at Little Rock School of Law, B.A. 1969, Hanover College; M.A. 1970, J.D. 1982, University of Kentucky. The author wishes to thank Professor Morell E. Mullins for his time in serving as a sounding board and for his insight on statutory construction. Additionally, the author wishes to thank research assistant, Christa Suzanne Clark, for her diligent assistance.

1. See Lary Lawrence, *Misconceptions About Article 3 of the Uniform Commercial Code: A Suggested Methodology and Proposed Revisions*, 62 N.C. L. REV. 115, 124 n.73 (1983) (identifying prior drafts and the years they were

New Payments Code,³ in 1990 the National Conference of Commissioners on Uniform State Laws promulgated Revised Article 3 to the Uniform Commercial Code ("Revised Article 3").⁴ Former Article 3 received much criticism.⁵ Unfortunately, Revised Article 3 is not hailed as a work of great clarity, as it fails in many ways to enlighten what is often considered one of the most complex and difficult areas of commercial law.⁶ Quite the contrary, Revised Article 3 presents sections in a wordy, verbose style,⁷ containing: (1) traps for the unwary or untutored, (2)

proposed).

2. See Fred H. Miller, *Report on the New Payments Code*, 41 BUS. LAW. 1007, 1008 (1996) (recounting the determination by the Permanent Editorial Board in June 1984 that the intense criticism received by the New Payments Code justified discontinuing its attempted promulgation).

3. With burgeoning electronic commerce and surging innovations in electronic payment devices, the time is ripe for a unitary approach to multifaceted payment systems. At the average checkout counter, a purchaser is confronted with the option of using a debit card or a credit card; drawing and issuing a check; permitting the merchant to draft the check for the customer's signature; or using or reusing an electronic check. Certainly now, a new payments code would provide guidance in resolving conflicts and disputes that are bound to surface.

4. See U.C.C. art. 3 (1990). [Ed. Note: Throughout this article, Revised Article 3 of the Uniform Commercial Code is distinguished from Former Article 3 by referencing its year of promulgation, 1990. All references to Former Article 3 of the Uniform Commercial Code are made to the prior year, 1989.]

5. See, e.g., Steven B. Dow & Nan S. Ellis, *The Payor Bank's Right to Recover Mistaken Payments: Survival of Common Law Restitution Under Proposed Revisions to Uniform Commercial Code Articles 3 and 4*, 65 IND. L.J. 779, 780-81 (1989-1990) (asserting that Former Article 3 was unclear as to whether it displaces common law restitutionary actions and fails to clarify the rules regarding a bank's right to restitution in mistaken payment cases); Sarah Howard Jenkins, *A Payee Who Is a Holder in Due Course May Be Subject to Personal Defenses Arising from Unauthorized Acts or Promises by an Agent*, 9 ST. LOUIS U. PUB. L. REV. 191, 194-96 (1990) (criticizing Former Article 3's ambiguity with regard to which defense a payee, who satisfies the requirements for holder in due course status, is subject); Lawrence, *supra* note 1, at 119-20 (calling for a complete revision); Julian B. McDonnell, *The Code Project Confronts Fundamental Dilemmas*, 26 LOY. L.A. L. REV. 683, 686-87 (1993) (detailing how Former Article 3 risked becoming obsolete by the time of enactment).

6. See Ada Long-Croom, *Unauthorized and Forged Indorsements: A Glitch in Revised Article 3 of the Uniform Commercial Code*, 37 SANTA CLARA L. REV. 349, 351, 379-80 (1997) (demonstrating how Revised Article 3 leaves a major loophole in attempting to shift loss allocation to the negligent payee on a forged indorsement, allowing the negligent party to avoid the loss). See generally Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4*, 26 LOY. L.A. L. REV. 743 (1993) (narrating the process by which the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL) promulgated Revised Article 3 and decrying the lack of representation by consumer groups and the intense lobbying by the ALI and the NCCUSL on behalf of the banking industry).

7. See generally Louis F. Del Duca et al., *Applying Plain English Techniques in Revising the UCC*, 29 UCC L.J. 428 (1997) (identifying ways in which the UCC could be improved by drafting with an eye towards readability); Steven O. Weise, *"Plain English" Will Set the UCC Free*, 28 LOY. L.A. L. REV. 371 (1994)

serious omissions,⁸ and (3) rules that are unjustified by and inconsistent with historical and contemporary thought.⁹ During Revised Article 3's short nine-year history, much of the period has been spent winning acceptance in the various statehouses across the nation.¹⁰ In fact, New York, a major commercial law jurisdiction, has yet to sign-on to the revision.¹¹ Revised Article 3 does contain, however, many redeeming features. For example, Revised Article 3 adopts agency rules consistent with prevailing agency law principles;¹² accord and satisfaction rules that accommodate the modern processing of payments made to large businesses through lock boxes;¹³ and clarification of the conflict between the rules on restitution for mistaken payment and final payment,¹⁴ just to mention a few.

Despite the short history of Revised Article 3, this Article urges the American Law Institute and the National Conference of Commissioners on Uniform State Laws to confront the difficult and unpleasant issue of revising, yet again, Revised Article 3 to correct the aberrant suretyship rules. Revised Article 3 contains suretyship rules, the law governing one of the most prevalent

(recommending techniques to improve the readability of the UCC, making it easier to interpret and apply by courts and practitioners).

8. One such omission appears in Section 3-309, which is entitled "Enforcement of Lost, Destroyed, or Stolen Instrument." U.C.C. § 3-309 (1990). The remedial rights granted in the section are unavailable, by definition, to a remitter or purchaser of cashier's checks. *See id.* This omission was corrected by the 1991 amendment, which added Section 3-312 to Revised Article 3. *See NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, AMENDMENTS TO UNIFORM COMMERCIAL CODE REVISED ARTICLE 3, amend. 1. cmt. 1 (1991).* The states that enacted Revised Article 3 before the amendment must amend their prior adoption, or banks must insist on a lost instruments bond or other devices to protect themselves in the event a holder in due course presents the purportedly lost instrument. *See id.*; U.C.C. § 3-309 (1990).

9. *See, e.g.,* U.C.C. § 3-605 (1990) (eliminating, for example, the necessity of a creditor to explicitly reserve rights against an accommodation party and allowing the creditor to make material modifications to the contractual relationship between the parties, thereby changing the risk assumed by the accommodation party without her consent). Refer to notes 135-45 *infra* and accompanying text (critiquing this change).

10. *See State UCC Variations Binder, U.C.C. Rep. Serv. (CBC), at xix-xx (Jun. 1999)* (showing enactment dates for Revised Article 3 ranging from mid-1991 up to early 1998).

11. *See id.* at xix. As of June 1999, New York, Rhode Island, South Carolina, and three U.S. territories (the Northern Mariana Islands, the Virgin Islands, and the territory of Guam) had not adopted Revised Article 3. *See id.* Massachusetts only recently enacted Revised Article 3 in May of 1998. *See id.*

12. *See U.C.C. § 3-402 cmt. 1 (1990)* (eliminating the Former Article 3 exception to ordinary agency law and binding an undisclosed principal to an instrument, even if she has not signed it).

13. *See U.C.C. § 3-311(c) (1990).*

14. *See U.C.C. §§ 3-418 & cmt. 1, 4-215(d) (1990).*

credit enhancement devices, that diverge without reasonable justification from both historical and contemporary principles. This Article illustrates, through the use of a hypothetical problem, the potential for confusion that results when Revised Article 3's conflicting rules must be applied simultaneously with general suretyship law as reflected in the *Restatement (Third) of Suretyship and Guaranty* ("Restatement").¹⁵ In addition to recommending the revision of the suretyship rules, this Article identifies several other needed revisions.¹⁶

Initially, this call for revision raises as a concern the use of the supplementary PEB Commentary as a quasi-legislative tool to address problems inherent in the revised Article's suretyship rules. In the context of these rules, what is the impact of the PEB Commentary, substantially modifying or revising the Official Comments, on those jurisdictions that codified the revision prior to the substantial modification? Does a non-uniform adoption result?

I. PEB COMMENTARY

In 1987, the Permanent Editorial Board of the Uniform Commercial Code (UCC) was empowered by the American Law Institute and the National Conference of Commissioners on Uniform State Laws to issue supplemental commentary on the UCC.¹⁷ PEB Commentary may be used: (1) to resolve an ambiguity by stating what the PEB considers to be the legal rule; (2) to state a preferred resolution if judicial opinions or scholarly writings diverge; (3) to elaborate on the application of the UCC if the statute or Official Comments create doubt as to its applicability to particular circumstances or transactions; (4) to apply the principles of the UCC to new or changed circumstances, consistent with Section 1-102(2)(b); (5) to clarify or elaborate on the operation of the UCC with other statutes (such as the Bankruptcy Code and various federal and state consumer protection statutes) and general principles of law and equity pursuant to UCC Section 1-103; or (6) to otherwise improve the operation of the UCC.¹⁸ Use of the PEB Commentary

15. Refer to notes 97-237 *infra* and accompanying text.

16. Refer to notes 237-99 *infra* and accompanying text.

17. See *PEB Resolution on Purposes, Standards, and Procedures for PEB Commentary to the UCC*, (Mar. 14, 1987), reprinted in [Findex & PEB Commentary Binder] U.C.C. Rep. Serv. (CBC), at vii (1990) [hereinafter *PEB Resolution*]; see also *Huffman v. Altec Int'l, Inc.*, 546 N.W.2d 162, 165 & n.4 (Wis. Ct. App. 1996) (referring to the PEB as the "watchdog" of the Uniform Commercial Code).

18. See *PEB Resolution*, *supra* note 17, at vii.

to supplement the Official Comments prevents obsolescence¹⁹ and promotes uniformity of construction.²⁰ Several courts have cited the PEB Commentary in support of or as authority for their holdings.²¹

Although the Official Comments are not part of the statute unless affirmatively enacted,²² they should be deemed part of the legislative history of the adopted statutes and should be treated as an extrinsic aid relevant for construing the statutes and determining legislative intent at the time the statutes were adopted.²³ Because the Official Comments were "clearly and

19. See Peter Winship, *As the World Turns: Revisiting Rudolf Schlesinger's Study of the Uniform Commercial Code "In the Light of Comparative Law,"* 29 LOY. L.A. L. REV. 1143, 1152-53 (1996) (discussing how Professor Schlesinger's recommendation to "constantly recodify" the UCC to avoid obsolescence ultimately led to the creation of the PEB).

20. See Fred H. Miller & Donald J. Rapson, *Status Report on the UCC-1998, in THE EMERGED AND EMERGING NEW UNIFORM COMMERCIAL CODE 15, 16 (ALI-ABA Course of Study, Dec. 10, 1998), available in Westlaw, SD30 ALI-ABA 1.*

21. See, e.g., *Bluegrass Ford-Mercury, Inc. v. Farmers Nat'l Bank*, 942 F.2d 381, 386 (6th Cir. 1991) (citing the PEB Commentary to clarify a potential conflict between two sections of Article 9); *In re Solfanelli v. Meridian Bank*, 206 B.R. 699, 711 (Bankr. M.D. Pa. 1996) (citing the PEB Commentary as authority for the proposition that a breach of the obligation of good faith cannot be used to support an independent cause of action), *aff'd in part, rev'd in part on other grounds*, 230 B.R. 54 (M.D. Pa. 1999); *In re LMS Holding Co.*, 153 B.R. 581, 584 (Bankr. N.D. Okla. 1993) (supporting its holding that a security interest extends to after-acquired property not transferred by the debtor by reference to PEB Commentary), *rev'd on other grounds sub nom.*, *LMS Holding Co. v. Core-Mark Mid-Continent, Inc.*, 50 F.3d 1520 (10th Cir. 1995); *Florida E. Coast Properties, Inc. v. Best Contract Furnishings, Inc.*, 593 So. 2d 560, 562 & n.5 (Fla. Dist. Ct. App. 1992) (relying on the PEB Commentary, revising the Official Comment to Section 2-507, which had limited the right of reclamation in cash sales to the same ten day period imposed in credit transactions under Section 2-702, as an unjustified limitation on the implied continuation in the statute of the common law precedent); *Continental Grain Co. v. Heritage Bank*, 548 N.W.2d 507, 512 & n.1 (S.D. 1996) (Konenkamp, J., concurring) (citing PEB Commentary No. 1 Section 2-507, which eliminated any specific time limit for a cash seller to exercise the right of reclamation).

22. The UCC Reporting Service in the State UCC Variations volume incorrectly includes as a variation for 33 jurisdictions the codification of the Official Comments. See generally *State UCC Variations Binder, UCC Rep. Serv. (CBC) (March 1999).*

23. See Peter A. Alces & David Frisch, *Commenting on "Purpose" in the Uniform Commercial Code*, 58 OHIO ST. L.J. 419, 436-41 & n.63, 448-55 (1997) (observing that the comments should be the single best source of purpose and policy but questioning the validity of that assumption given the historical process followed in their drafting). *But see American Nat'l Bank of Denver v. Christensen*, 476 P.2d 281, 285-86 (Colo. Ct. App. 1970) (holding that limiting the protections of Section 2-326(3) to general creditors based on the language of comment 2, to construe the term "creditor" rather than the general definition of creditor from Section 1-201(12), was an error by the trial court, relying on the Preface to the Uniform Commercial Code as enacted by the Colorado Legislature, which states that "official comments, the references contained in these comments and the cross references are nonstatutory and the inclusion of this nonstatutory matter is for the purpose of information

prominently communicated" or were at least available to the various legislatures when the bills enacting the UCC were being considered, the individual legislators' understanding of the bills, presumably, was influenced by the views of the draftspersons or sponsoring agencies; and the views expressed in the Official Comments provide persuasive evidence to courts, educators, and practitioners for determining the statutes' meaning.²⁴

Additionally, traditional principles of statutory construction recognize that a statute should not be limited to those situations within the contemplation of the legislature when the statute was adopted and that judicial authority extends to the application of the purpose and policy of the statute in unforeseen contexts.²⁵ Furthermore, use of "extra-legislative" source materials when legislative resources do not resolve a question is a well-established principle within the traditional approaches to statutory interpretation²⁶ and is consistent with the stated function of the Resolution authorizing the issuing of the PEB Commentary.²⁷

Moreover, proponents of less traditional approaches, such as dynamic statutory interpretation, advance a thesis that statutory interpretation should be dynamic; that is, the interpretation of a

only.").

24. Norman J. Singer, 2A SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION § 48.12 (5th ed. 1992) [hereinafter 2A SUTHERLAND]; Norman J. Singer, 2B SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION § 52.05 (5th ed. 1992) [hereinafter 2B SUTHERLAND]; *accord* *Jinright v. Russell*, 182 S.E.2d 328, 330 (Ga. Ct. App. 1971) (noting that by virtue of the Official Comments, "The legislature had the benefit of the drafter's interpretations when it enacted the Code . . . and we cannot say that it intended something else . . .") (quoting *Kramer v. Johnson*, 176 S.E.2d 108, 109 (Ga. Ct. App. 1970)); *Pastor v. National Rep. Bank of Chicago*, 371 N.E.2d 1127, 1128-29 (Ill. App. Ct. 1977) (determining whether the Illinois Commercial Code permitted assignment of an irrevocable letter of credit by the beneficiary by reviewing the evolution of the final draft and official comments to the UCC to determine the legislature's intent), *aff'd*, 390 N.E.2d 894 (Ill. 1979); *John Deer Co. v. Jeff DeWitt Auction Co.*, 690 S.W.2d 511, 514 (Mo. Ct. App. 1985) ("[I]n construing uniform model acts enacted by the General Assembly, [the court] must assume [the legislature] did so with the intention of adopting the accompanying interpretations placed thereon by the drafters of the model or uniform act."); *Leake v. Meredith*, 267 S.E.2d 93, 95 (Va. 1980) (noting that, in a suit for breach of implied warranty of fitness arising from the lease of goods under Article 2, the court, in addressing applicability of the section to a lease of goods, stated that the Official Comments were "frequently helpful in discerning legislative intent . . . [but they] should not become devices for expanding the scope of Code sections").

25. See 2A SUTHERLAND, *supra* note 24, § 45.09.

26. See *id.*; see also Frederick J. de Sloovere, *Extrinsic Aids in the Interpretation of Statutes*, 88 U. PA. L. REV. 527, 548-49 (1940).

27. See *PEB Resolution*, *supra* note 17, at vii (stating that the function of the PEB Commentary is, *inter alia*, "to elaborate on the application of the UCC where the statute and/or the Official Comments leaves doubt as to inclusion or exclusion of, or application to, particular circumstances or transactions").

provision “is not necessarily the one which the original legislature would have indorsed, and *as the distance between enactment and interpretation increases*, a pure originalist inquiry becomes impossible and/or irrelevant.”²⁸ This doctrinal approach to statutory construction suggests that interpretation by courts and agencies “over time,” after the original intent has been determined, is subject to adjustment to accommodate the evolution of culture and society, “as society . . . adapts to the statute, and generates new variations on the problem initially targeted by the statute.”²⁹ Clearly, the PEB Commentary serves as a tool or mechanism for dynamic interpretation of the UCC by representatives appointed by its sponsoring agencies, the ALI and NCCUSL.³⁰ This mechanism brings about an evolution in interpretation consistent with the policy goals reflected in Section 1-102, namely, clarity of commercial laws and uniformity of construction.³¹ PEB Commentary No. 3 Sections 9-306(2) and 9-402(7) (“PEB Commentary No. 3”) is an example of this role of the Commentary.³² PEB Commentary No. 3 serves a coordinating and harmonizing function by clarifying a conflict between two sections of Article 9 (1972) on the survivability of a security interest upon the transfer of collateral by the debtor when authorized or consented to by the secured party.³³ The Commentary was not only promulgated eighteen years after the relevant statutory provisions but also after prior case authority construed the relationship between the two provisions.³⁴ Similarly, PEB Commentary No. 1 Section 2-507 (“PEB Commentary No. 1”) revised Official Comment 3 to Section 2-507. The language of the Official Comments limited the seller’s right

28. WILLIAM N. ESKRIDGE, JR., *DYNAMIC STATUTORY INTERPRETATION* 5-6 (1994) (emphasis added).

29. *Id.* at 9-10. *But see* Anthony D’Amato, *Robert S. Marx Lecture: The Injustice of Dynamic Statutory Interpretation*, 64 U. CIN. L. REV. 911, 912 (1996) (arguing that the separation of powers doctrine provides insurance against courts taking on “quasi-legislative powers”).

30. *See PEB Resolution*, *supra* note 17, at viii (declaring that the PEB Commentary may be issued “whether or not a perceived issue has been litigated or is in litigation, and whether or not the position taken by the PEB accords with the weight of authority on the issue.”).

31. *See* U.C.C. § 1-102 (1999).

32. PEB Commentary on the Uniform Commercial Code: Commentary No. 3 (Mar. 10, 1990), *reprinted in* U.C.C. Rep. Serv. (CBC) [Findex/PEB Commentaries 1990] [hereinafter PEB Commentary No. 3].

33. *See id.*

34. *See id.*; *Bluegrass Ford-Mercury, Inc. v. Farmers Nat’l Bank*, 942 F.2d 381, 386 (6th Cir. 1991) (holding that a secured party’s assertion that its perfected security interest in transferor’s inventory extended to inventory acquired by the transferee after the transfer).

of reclamation in cash sales to the same ten-day period imposed in credit transactions under Section 2-702. PEB Commentary No. 1 concluded that this limitation was an unjustified limitation on the implied continuation of common law precedent in the statute.³⁵ PEB Commentary No.1 adopted the minority view on the issue ten years after the majority view was rejected in *Burk v. Emmick*.³⁶

In the context of PEB Commentary No. 11—addressing the suretyship principles of Revised Article 3³⁷—the process of supplementary commentary went beyond the process espoused by dynamic interpretation. Here, substantial changes and elaborations were made early in the enactment process, with little time between enactment and interpretation, raising a scepter of quasi-legislative rewriting rather than interpretation of the text of the statute.³⁸

For the twenty-nine jurisdictions that enacted Revised Article 3 before the PEB Commentary was issued,³⁹ the Commentary was not a part of the legislative history. However, for those jurisdictions enacting the Revised Article after PEB Commentary No. 11 was issued in final form, the Commentary was part of the legislative history, altering the prior meaning of the statute and providing evidence of the intent of the legislators. A strong inference exists that such supplemental commentary has resulted in a non-uniform adoption of suretyship rules by those jurisdictions enacting prior to the Commentary, rules that

35. See PEB Commentary on the Uniform Commercial Code: Commentary No. 1, at 4 (Mar. 10, 1990), *reprinted in* U.C.C. Rep. Serv. (CBC) [Findex/PEB Commentaries 1990] [hereinafter PEB Commentary No. 1]; see also *Florida E. Coast Properties, Inc. v. Best Contract Furnishings, Inc.*, 593 So. 2d 560, 562 & n.5 (Fla. Dist. Ct. App. 1992) (holding that the seller improperly asserted a right to reclaim goods under Section 2-507 from the landlord who acquired them under the terms of the lease agreement with the buyer based on the revised Official Comment).

36. 637 F.2d 1172 (8th Cir. 1980).

37. PEB Commentary on the Uniform Commercial Code: Commentary No. 11 (Feb. 10, 1994), *reprinted in* U.C.C. Rep. Serv. (CBC) [Findex/PEB Commentaries 1990] [hereinafter PEB Commentary, No. 11].

38. See *id.* The PEB Commentary was issued on February 10, 1994, less than three years after the enactment of Revised Article 3. See *id.*

39. See State UCC Variations Binder, *supra* note 8A, at xix. Arizona, Arkansas, California, Connecticut, Florida, Hawaii, Idaho, Illinois, Kansas, Louisiana (approved July 15, 1992; effective July 1, 1993; amended June 25, 1993; effective date extended to January 1, 1994), Minnesota, Mississippi, Missouri, Montana, Nebraska, New Mexico, North Dakota, Oklahoma, Pennsylvania, Utah, Virginia, West Virginia, and Wyoming all enacted Revised Article 3 prior to the issuance of either the proposed commentary (May 20, 1993) or PEB Commentary No. 11. See *id.* Alaska, Maine, Michigan, Nevada, New Hampshire, and Oregon all enacted Revised Article 3 within seven to thirty days after the proposed commentary was issued, but prior to the issuance of PEB Commentary No. 11. See *id.*

are distinguishable from the enactments following PEB Commentary No. 11.

II. SURETYSHIP — SOME SUBTLE BUT SIGNIFICANT ISSUES

At early common law, the surety was recognized as the “favorite of the law.”⁴⁰ This preferred status was reflected in the surety’s complete discharge of its obligation upon *any* change by the creditor of the debtor’s obligation—no matter how slight the change or how beneficial the change to the surety (such as a reduction in the interest rate) and even though no harm resulted.⁴¹ This position as the “favorite of the law” was weakened as a result of the balancing of the equities between the surety and the creditor under the *Restatement of Security*⁴² and former Article 3.⁴³ Now, under Revised Article 3, the surety stands as the disfavored of the law, trading places with the creditor.⁴⁴

40. See, e.g., *National Bank of E. Ark. v. Collins*, 370 S.W.2d 91, 94 (Ark. 1963) (stating that the guarantor is a “favorite of the law” and that when the principal debtor was released upon payment, the obligation of the guarantor was likewise extinguished); *Citizens’ Trust Co. v. Tindle*, 199 S.W. 1025, 1029 (Mo. 1917) (acknowledging the doctrine that sureties are the “favorites of the law” and will not be held beyond the precise terms of the fidelity bond); *Buck v. Reed*, 363 S.W.2d 479, 483 (Tex. Civ. App.—Austin 1962) (holding that surety is a favorite of the law and that the liability of the surety is “strictissimi juris”), *rev’d on other grounds*, 370 S.W.2d 867 (Tex. 1963).

41. See ARTHUR ADELBERT STEARNS, *THE LAW OF SURETYSHIP* § 79 (4th ed. 1934) (noting that the view that a surety’s obligations should not be discharged when a change in the obligation has been made to his benefit has generally been rejected on public policy grounds).

42. See generally *RESTATEMENT OF SECURITY* §§ 114-143 (1941) (eliminating, for example, the complete discharge of the surety when a modification to the original terms of the agreement are beneficial to the surety and the automatic discharge of the surety when the principal and the creditor make an agreement to extend the time of payment by the principal).

43. For example, Former Section 3-606 provides:

(1) The holder discharges any party to the instrument to the extent that without such party’s consent the holder

(a) without express reservation of rights releases or agrees not to sue any person against whom the party has to the knowledge of the holder a right of recourse or agrees to suspend the right to enforce against such person the instrument or collateral or otherwise discharges such person, except that failure or delay in effecting any required presentment, protest or notice of dishonor with respect to any such person does not discharge any party as to whom presentment, protest or notice of dishonor is effective or unnecessary; or

(b) unjustifiably impairs any collateral for the instrument given by or on behalf of the party or any person against whom he has a right of recourse.

U.C.C. § 3-606(1) (1989).

44. See, e.g., U.C.C. § 3-605 cmts. 2, 4 (1990) (stating that, in direct contrast with the common law, an extension of time given by the creditor to the principal no

Unlike Revised Article 3, the *Restatement*,⁴⁶ the second most significant review and assessment of the rights and duties of the surety in the 1990s, provides greater parity between the interest of the surety (denominated secondary obligor by the *Restatement*) and the creditor or the obligee. Under UCC Section 1-103, the general law of suretyship, as reflected in the *Restatement* and case authority, remains relevant to suretyship issues raised under the revised Article.⁴⁶ Coordination of rights under Revised Article 3 and the *Restatement* produces some subtle and significant variations in results. Care must be taken in determining the applicability of each body of rules and in distinguishing the effect of the rules. As the following analysis demonstrates, the suretyship principles of Revised Article 3 should head the list of provisions to be revised again.⁴⁷

A. Accommodation and Accommodated Parties

In litigation under the former Article, courts often had difficulty (and continue to have difficulty) determining the status of one who signed as an accommodation party with the purpose of "lending his name to another party to" the instrument.⁴⁸ Accommodation status was often denied to a party who signed as a maker or who received a benefit, no matter how indirect or tenuous.⁴⁹ Revised Article 3 clarifies this issue by expressly

longer discharges the surety, unless it can be proven that the surety suffered a loss as a result of the extension of time).

45. RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY (1996) [hereinafter RESTATEMENT (THIRD)].

46. See U.C.C. § 1-103 (1999).

47. The November 20, 1989 draft of Section 3-606 imposed a duty on the creditor to make a written reservation of right and to give the surety notice of the discharge of the accommodated party in order to prevent the discharge of the surety. See U.C.C. § 3-606 (Tentative draft of November 20, 1989). Between late November and early May, the drafting committee made a 180-degree turn in the focus and direction of the section. See U.C.C. § 3-605 cmt. 3 (1990) (changing Former Section 3-606 by eliminating any duty on the part of the creditor to formally reserve rights).

48. See Neil O. Littlefield, *Payments: Articles 3, 4, and 4A*, 52 BUS. LAW. 1527, 1529 (1997); see, e.g., *First Dakota Nat'l Bank v. Maxon*, 534 N.W.2d 37, 41-42 (S.D. 1995) (holding that accommodation status arises only upon indorsement outside the chain of title despite language in the statute that an accommodation party may sign in any capacity). *But see Glimcher v. Reinhorn*, 587 N.E.2d 462, 465 (Ohio Ct. App. 1991) (applying Former Article 3 and finding that an accommodation party's obligation is determined by the capacity in which he signs).

49. See, e.g., *Cooperative Fin. Ass'n v. Garst*, 917 F. Supp. 1356, 1387 (N.D. Iowa 1996) (holding that a wife who was not a partner in the business enterprise and did not receive any benefit from the loan other than her husband's continuing investment was not entitled to summary judgment on accommodation status); *FDIC v. Blue Rock Shopping Ctr., Inc.*, 676 F. Supp. 552, 558 (D. Del. 1987) (stating that value received used to retire corporate loan on which officers were co-signers constituted a benefit negating accommodation status); *Lasky v. Berger*, 536 P.2d

providing that an accommodation party may sign the instrument in any capacity—as a maker, drawer, acceptor, or indorser—and is only denied accommodation party status if a direct benefit is received from the value given for the instrument.⁵⁰ Thus, an accommodation party who is also an officer of a corporation that receives loan funds to be used as working capital is still an accommodation party, even though the officer signed individually as a maker and received a previously set salary paid from the proceeds of the loan, the same as any other employee.⁵¹ Here, the corporation is the direct beneficiary of the value received for the instrument, not the officer.⁵²

Under Former Article 3 Section 3-415, “accommodated party” was not a defined term. Instead, its definition arose by implication from the definition of “accommodation party.”⁵³ The accommodation party was that party to the instrument who was “lending his name to another party” to the instrument.⁵⁴ Hence, the accommodated party was the party to whom the accommodation party was lending his name.⁵⁵

1157, 1159 (Colo. Ct. App. 1975) (finding that the creditor served as an undisclosed accommodation party on a loan for its debtor and was denied accommodation status when the creditor sought reimbursement from the debtor's father, the other undisclosed accommodation party).

50. See U.C.C. § 3-419(b) & cmt. 1 (1990).

51. See *Citibank v. Van Velzer*, 36 U.C.C. Rep. Serv. 2d (CBC) 145, 147-48 (Ariz. Ct. App. 1998) (holding that the receipt of a limited partnership interest and a construction contract by the accommodation party for serving in this position is an indirect benefit and does not change the party's status); *Chandler v. Maxwell Manor Nursing Home, Inc.*, 666 N.E.2d 740, 750-51 (Ill. App. Ct. 1996) (identifying employment compensation or shareholder dividends as indirect benefits in construing and employing the UCC “accommodation party” test, and absent a direct benefit, as persuasive authority for determining if a party to a contract was a surety).

52. See, e.g., U.C.C. § 3-419 cmt. 1 (1990).

53. U.C.C. Section 3-415 provides: “An accommodation party is one who signs the instrument in any capacity for the purpose of lending his name to another party to it.” U.C.C. § 3-415(1) (1989).

54. *Id.*

55. See, e.g., *Pioneer Ins. Co. v. Gelt*, 558 F.2d 1303 (8th Cir. 1977). In *Gelt*, a maker signed a note to acquire funds on behalf of a lender's (payee's) stockholder-officer to be used by him to acquire stock of a corporation that later merged with the lender. See *id.* at 1308. The lender sued on the note, and the maker asserted that it was an accommodation party. See *id.* at 1310. The court held that the maker was not an accommodation party because the maker was not lending its name to another party to the instrument. See *id.* at 1311. The facts suggested that the entities were alter egos of the stockholder-officer. See *id.* at 1311. As such, the payee, a party to the instrument, was the accommodated party. Another example is *Berkshire Bank v. Schwartz*, 191 A.2d 260 (N.Y. App. Div. 1993). In *Schwartz*, the bank, with knowledge of the maker's capacity, made a loan to a sole signatory, a surety incorrectly termed an accommodation maker under Former Article 3. See *id.* The signatory immediately paid the proceeds to a third party. See *id.* Although the third party was the direct beneficiary of the proceeds, it was not a party to the instrument

Unlike the former Article, Revised Article 3 defines and limits the classes of parties who may become accommodated parties.⁵⁶ By definition, accommodated party status is available only to those who were parties to the instrument at the *time of issuance* and *for whose benefit* value is given *at the time of issuance*.⁵⁷ Consequently, any party to the instrument whose obligation arose after issuance and for whom another becomes a surety will not be deemed to be an accommodated party under Revised Article 3. If a post-issuance accommodation occurs, this definition will create an obstacle to applying Section 3-419 and correctly determining the rights and remedies that suretyship status accords accommodation parties. As a result of this change in definition, general suretyship law will govern the rights between this obligor—called the principal obligor under the *Restatement*—on the instrument and its surety—the secondary obligor—who is also a party to the instrument.⁵⁸ Because the principal obligor was either not a party when the instrument was issued or was a party at issuance, but the instrument was issued for another's benefit, the obligor is not an accommodated party. Although the obligor's relationship to another party to the instrument is a suretyship one, Revised Article 3 will not govern this suretyship relationship but will govern the rights and duties between the one who falls within the narrow definition of "accommodated party" and the same surety on the same instrument. This technical difference creates difficulty for the creditor because the surety, who is a secondary obligor to one party and an accommodation party to another, will have greater protection under the general law of suretyship than under Revised Article 3.⁵⁹ Potential areas of difference between rights and remedies of general suretyship law as reflected in the *Restatement* and Revised Article 3 include: the right of reimbursement, the right of enforcement or subrogation, and the obligation to preserve the secondary obligor's right of recourse, formerly called the doctrine of reservation of rights.⁶⁰

and was not an accommodated party. *See id.* If the bank had a right of enforcement against the third party, general suretyship law should govern the rights between the maker and the third party. Refer to note 46 *supra* and accompanying text. If not, the maker is not a surety and only has a right to be indemnified based upon an express or implied contract.

56. *See* U.C.C. § 3-419(a) (1990).

57. *See* PEB Commentary No. 11, *supra* note 37, at 2; U.C.C. §§ 3-105(a), 3-419(a) (1990).

58. *See* PEB Commentary No. 11, *supra* note 37, at 2.

59. Refer to notes 61-98 *infra* and accompanying text.

60. Refer to notes 61-98 *infra* and accompanying text.

B. *Accommodation Party's Rights Against the Accommodated Party*

1. *Reimbursement.* General suretyship law imposes an obligation upon the principal obligor to reimburse its surety or secondary obligor.⁶¹ This duty of reimbursement arises from an implied contract after maturity and payment or performance of the underlying obligation by the secondary obligor.⁶² If the principal obligor is not chargeable with notice of the secondary obligation (for example, when the creditor obtained a secondary obligor after the principal obligor concluded the transaction without informing the principal obligor) then the secondary obligor is not entitled to reimbursement but may still recover in restitution for any benefit received by the principal obligor.⁶³ The secondary obligor is permitted to recover to prevent the unjust enrichment of the principal obligor from the performance of the secondary obligor.⁶⁴ Recovery, however, is limited to the amount of the principal obligor's enrichment rather than the reasonable outlay by the secondary obligor.⁶⁵ Such an outlay might include reasonable expenses incurred by the secondary obligor in determining the existence of any defenses or in asserting defenses of the principal obligor.⁶⁶ The *Restatement* also includes reasonable incidental expenses and attorneys fees as part of a claim for reimbursement.⁶⁷

Similar to the *Restatement* principles, Revised Article 3 statutorily authorizes a right to reimbursement upon payment by

61. See *RESTATEMENT (THIRD)*, *supra* note 45, § 22(1)(a)-(b). The *Restatement's* Section 22(1) provides:

- (1) Except as provided in § 24, when the principal obligor is charged with notice of the secondary obligation it is the duty of the of the principal obligor to reimburse the secondary obligor to the extent that the secondary obligor:
- (a) performs the secondary obligation; or
 - (b) makes a settlement with the obligee that discharges the principal obligor, in whole or part, with respect to the underlying obligation.

Id.

62. See *id.* § 22(1) cmt. a.

63. The *Restatement's* Section 26 provides:

The secondary obligor is entitled to restitution from the principal obligor to the extent that the secondary obligor's performance of the secondary obligation, or settlement with respect to it, relieves the principal obligor of its duty pursuant to the underlying obligation and the principal obligor has no duty to reimburse the secondary obligor for the cost of its performance.

Id.

64. See *id.*

65. See *id.* cmts. a, d.

66. See *id.* § 23 cmt. a

67. See *id.*

the accommodation party.⁶⁸ By its terms, Revised Article 3 appears to authorize reimbursement in all cases. This position was clarified in PEB Commentary No. 11.⁶⁹ Revised Official Comment 5 to Section 3-419 reflects an intent to modify the rule of reimbursement that exists under the general law of suretyship and to displace the rule of restitution.⁷⁰ Without justification, the PEB Commentary asserts that the "right [to reimbursement] is not limited," and further provides that "the right of restitution that is present in the general law of suretyship is superfluous."⁷¹ Despite the language of PEB Commentary No. 11, can an accommodated party who did not know of the accommodation limit the accommodation party's recovery to restitution in those jurisdictions that enacted the Revised Article before the 1994 PEB Commentary? Twenty-nine jurisdictions enacted the revisions to Article 3 with an effective date before PEB Commentary No. 11 was published in final form.⁷² In these jurisdictions, assuming the requirements of current Section 1-103 and its commentary are met, that is, the general law of restitution has not been "explicitly displaced," does the general law of suretyship supplement and the distinction between reimbursement and restitution remain relevant?⁷³ The concern is one of fairness to the accommodated party, who has not requested, assented, or consented to the accommodation of its obligation nor was provided with notice that an accommodation was necessary or subsequently acquired. Should restitution be available to prevent abuse by a holder who is closely associated with the accommodation party or who maintains an ongoing business relationship with the accommodation party?⁷⁴ Revising

68. See U.C.C. § 3-419(e) (1990) ("An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party . . .").

69. See PEB Commentary No. 11, *supra* note 37, at 3-4 (asserting that Revised Section 3-419(e) codifies the accommodation party's right to be reimbursed by the accommodated party—a right which, unlike the general law of suretyship, is not limited to situations in which the accommodated party was charged with notice of the accommodation party's obligation).

70. See *id.*; U.C.C. § 3-419 cmt. 5 (1990).

71. See PEB Commentary No. 11, *supra* note 37, at 3-4.

72. Refer to note 39 *supra* and accompanying text.

73. See U.C.C. § 3-419 cmts. 6 & 7 (1990); see, e.g., *Venaglia v. Kropinak*, 956 P.2d 824, 834-36 (N.M. Ct. App. 1998) (authorizing the supplementation of discharge under Section 3-605 with common law principles of discharge for impairment of recourse recognized under *Restatement* Section 44).

74. See Sarah Howard Jenkins, *Abrogation of Surety's Right of Discharge on Release of the Principal Obligor Under Revised Article 3: A Creditor's Tool for Maximizing Self-Interest*, 44 OKLA. L. REV. 661, 666-68 (1991) (asserting that, to minimize abuse, reimbursement against a nonconsenting debtor should be limited to the amount paid to the creditor).

Revised Article 3 would provide an opportunity to address the need, if any, for limiting the right of reimbursement or, at least, for justifying the change in the common law rule.

2. *Subrogation.* General suretyship law authorizes subrogation, the surety's standing in the shoes of the obligee and recovering from the principal obligor on the basis of the obligee's rights.⁷⁵ After total satisfaction of the underlying obligation, the secondary obligor is subrogated to all rights of the obligee to the extent of performance by the secondary obligor.⁷⁶

Under Revised Article 3, subrogation remained in a state of flux until the final draft of the PEB Commentary. Initially, Revised Article 3 neither authorized subrogation nor abolished it but rather granted the accommodation party a right to enforce the instrument acquired from the obligee.⁷⁷ Furthermore, the PEB Commentary initially took conflicting positions on subrogation. First, the Commentary stated that the right to enforce authorized in Section 3-415 was "essentially" a codification of the general law of suretyship right of subrogation.⁷⁸ Second, in the proposed text of revised comment 4 to Section 3-605 on the effect of an extension on the accommodation party's right to enforce the instrument, the text distinguishes the right to enforce from subrogation.⁷⁹ However, the final draft of PEB Commentary No. 11 took the position that the accommodation party's right to enforce the instrument after payment was "essentially" the codification of the right of subrogation and deleted the contrary position from revised comment 4 to Section 3-605.⁸⁰

Two consequences flowed from the early attempt to distinguish the right to enforce the instrument from subrogation. The first consequence created some difficulty for the accommodation party. By enforcing the instrument, but not as a subrogee, the accommodation party no longer stood in the shoes of the obligee who may have been a subsequent holder in due

75. See RESTATEMENT (THIRD), *supra* note 45, § 27 & cmt. a.

76. See *id.* (noting that "since the underlying obligation has been satisfied, no interest of the obligee is prejudiced by permitting the secondary obligor to enforce the obligee's rights").

77. Section 3-419(e) provides that: "an accommodation party who pays the instrument . . . is entitled to enforce the instrument against the accommodated party." U.C.C. § 3-419(e) (1990).

78. See PEB Commentary on the Uniform Commercial Code: Proposed Final Draft, at 3 (May 20, 1993) [hereinafter Proposed Final Draft].

79. See *id.* at 18.

80. See PEB Commentary No. 11, *supra* note 37, at 4; U.C.C. § 3-605 cmt. 4 (1990).

course. The accommodation party became, at best in its own right, a holder with notice that the instrument was overdue or subject to an uncured default⁸¹ and was, therefore, subject to all claims and defenses that the accommodated party might raise including any extension or release granted by the creditor.⁸² Second, because the drafters distinguished subrogation from the right to enforce, subrogation should be available through supplementation of Section 3-419 by the general law of suretyship. The comments did not reflect an intent to displace the doctrine of subrogation, but rather distinguished it from the right to enforce the instrument.

Additionally, subrogation, an equitable assignment or an assignment by operation of law, is a remedy designed to prevent the unjust enrichment of the principal obligor and is distinguishable from the Article's shelter doctrine, which grants the transferor's status in the instrument to a transferee.⁸³ Moreover, although a transfer is distinguishable from presentment,⁸⁴ the holder's demand for payment and the surrender of the instrument⁸⁵ should yield transferee status to

81. See U.C.C. § 3-302(2) (1990).

82. U.C.C. Section 3-302(e) provides:

If (i) the person entitled to enforce an instrument has only a security interest in the instrument and (ii) the person obligated to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

U.C.C. § 3-302(e) (1990).

83. Compare RESTATEMENT (THIRD), *supra* note 45, § 27 cmts. a, g, and ROBERT A. HILLMAN ET AL., COMMON LAW AND EQUITY UNDER THE UNIFORM COMMERCIAL CODE § 15.02[1] (1985), with U.C.C. § 3-201(1) & cmt. 3 (1990).

84. U.C.C. Section 3-501(a) provides:

"Presentment" means a demand made by or on behalf of a person entitled to enforce an instrument (i) to pay the instrument made to the drawee or a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, to the bank, or (ii) to accept a draft made to the drawee.

U.C.C. § 3-501(a) (1990).

85. U.C.C. Section 3-501(b)(2) (1990) provides:

(a) The following rules are subject to Article 4, agreement of the parties, and clearing-house rules and the like:

....

(2) Upon demand of the person to whom presentment is made, the person making presentment must (i) exhibit the instrument, (ii) give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so, and (iii) sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made.

the accommodation party.⁸⁶ Section 3-203 defines transfer as the delivery⁸⁷ by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.⁸⁸ Section 3-419 grants the accommodation party the right to enforce the instrument;⁸⁹ consequently, the accommodation party, upon surrender of the instrument by the holder, should be a transferee. Thus, the accommodation party, as a transferee, has available, under the shelter doctrine of Section 3-203(b), all of the holder's rights in the instrument against the accommodated party.⁹⁰ However, asserting the holder's rights under the shelter doctrine is not equivalent to the secondary obligor's rights under the historical doctrine of subrogation. The accommodation party as transferee would not accede to the holder's rights in any collateral given to secure the instrument. Happily, the final version of revised comment 5 to Section 3-419 gives the same effect to the right to enforce the instrument as existed under the former Article.⁹¹ "Under ordinary principles of suretyship the accommodation party who pays is subrogated to the rights of the holder paid, and should have his recourse on the instrument."⁹² In those twenty-nine jurisdictions that enacted Revised Article 3 before the effective date of PEB Commentary No. 11,⁹³ is the right of enforcement distinguishable from the historical right of subrogation? Must subrogation be asserted under Section 1-103 to be effective? Revising Revised Article 3 would resolve this dilemma.

3. *Preservation of Recourse.* To prevent the discharge of an accommodation party and to preserve the accommodation party's right of recourse against the accommodated party, Former Article 3, consistent with general suretyship law, permitted the holder (obligee) to reserve rights against the accommodation party when granting the accommodated party a release, an extension in time for payment, or other modification of the underlying obligation.⁹⁴ This reservation of rights, whether oral or written, resulted if the

Id. § 3-501(b)(2) (1990).

86. See *id.* § 3-203(a).

87. See U.C.C. § 1-201(14) (1999) (defining "delivery" as a voluntary transfer of possession).

88. See U.C.C. § 3-203(a) (1990).

89. See *id.* § 3-419(e).

90. See *id.* § 3-203(a)-(b).

91. See *id.* § 3-419 cmt. 5.

92. U.C.C. § 3-415 cmt. 5 (1989).

93. Refer to note 72 *supra*.

94. U.C.C. § 3-606(2) (1989).

obligee merely stated, "I am reserving my rights against the accommodation party." Consequently, the holder's rights against the accommodation party were preserved and, concomitantly, the accommodation party's rights were preserved against the accommodated party, even though the debtor might not understand the effect of the statement.⁹⁵

The *Restatement* continues this "preservation" of the right of recourse with the much needed requirement that the express terms of the release or extension preserve the recourse of both the obligee and the secondary obligor.⁹⁶ The secondary obligor's rights against the principal obligor are retained as though the release or extension did not occur.

Although the original commentary to Revised Section 3-605 abolished the doctrine of reservation of rights, the revised comment 3 to Section 3-605 eliminates the necessity of reserving rights to preserve recourse against the accommodation party, rather than abolishing the doctrine.⁹⁷ The accommodation party's rights are preserved by statutory law in Section 3-419.⁹⁸

Given the forgoing differences, consider the following hypothetical situation:

A and B are co-makers of a note payable to C. The note is issued for A's benefit alone to C. C seeks to discount the note to D, who insists on a surety for C's obligation. S indorses the note. What differences in outcome occur if

95. See Jenkins, *supra* note 74, at 669-72 (discussing the reservation of rights doctrine).

96. The *Restatement's* Section 39 provides:

To the extent that the obligee releases the principal obligor from its duties pursuant to the underlying obligation:

(a) the principal obligor is also discharged from any corresponding duties of performance and reimbursement owed to the secondary obligor unless the terms of the release effect a preservation of the secondary obligor's recourse (38);

(b) the secondary obligor is discharged from any unperformed duties pursuant to the secondary obligation unless:

(i) the terms of the release effect a preservation of the secondary obligor's recourse (§38); or

(ii) the language or circumstances of the release otherwise show the obligee's intent to retain its claim against the secondary obligor

RESTATEMENT (THIRD), *supra* note 45, § 39(a)-(b). The obligee's rights against the secondary obligor may be preserved in the absence of an express term in the release under limited circumstances. Refer to note 122 *infra* and accompanying text (discussing this limited exception).

97. Compare Proposed Final Draft, *supra* note 78, cmt. 3 at 15-17, with PEB Commentary No. 11, *supra* note 37, at 16-17.

98. See U.C.C. § 3-419(e) (1990). Refer to note 89 *supra* and accompanying text (stating that an accommodation party that pays the instrument is entitled to reimbursement from the accommodated party).

any of the following actions take place? *D* releases *C*; *D* releases *A* and *B*; *B* releases *A*; *S* releases *A*.

(1) *The Parties and Their Roles:*

A is a maker and the sole accommodated party.⁹⁹ The note was issued for value for *A*'s benefit alone.¹⁰⁰ *B*, who signed the instrument as a maker to incur liability without receiving a direct benefit of the value given, is an accommodation maker.¹⁰¹ Although not defined in Revised Article 3, *C* is the payee, the person to whom the instrument is payable, and an indorser.¹⁰² Therefore, Revised Article 3 will govern the rights and obligations of these three parties.

S signed the instrument to incur liability without being a direct beneficiary of the value given to *A* when the instrument was issued. Therefore, *S* is an accommodation party, despite the fact that *S*'s engagement arises after the instrument was issued.¹⁰³ *S*'s status as an accommodation party is further demonstrated by the placement of *S*'s signature outside the chain of title before *C*'s signature, indicating that *S* is an anomalous indorser, an indorser who is not a holder of the instrument and an accommodation party.¹⁰⁴ However, *S* is an accommodation party only for *A*, the sole accommodated party on the instrument and the only party for whose benefit value was given *at issuance*.¹⁰⁵ Therefore, Revised Article 3 will govern the rights and obligations among *A*, *B*, *S*, and *D*, the holder of the instrument.

In its relationship to *C*, *S* is a secondary obligor or surety.¹⁰⁶ The *Restatement* adopts a functional definition of suretyship, and

99. See U.C.C. § 3-419(a) (1990). Refer to note 58 *supra* (illustrating that an accommodated party is a party to an instrument that is issued for value given for his or her benefit).

100. See U.C.C. § 3-419(a) (1990).

101. See *id.* § 3-419(a)-(b).

102. See *id.* § 3-415(a).

103. See *id.* § 3-419(a)-(b).

104. See *id.* §§ 3-419 cmt. 3, 3-205(d) & cmt. 3; see, e.g., *J. & B. Schoenfeld Fur Merchants, Inc. v. Kilbourne & Donohue, Inc.*, 704 F. Supp. 466, 469 (S.D.N.Y. 1989) (holding that under Former Article 3, when a corporation's agent's signature indorses an instrument without any reference to his representative capacity outside the chain of title, it can be inferred that the agent is an accommodation indorser).

105. See U.C.C. § 3-419(a) (1990).

106. The *Restatement's* Section 1 provides:

(1) . . . [A] secondary obligor has suretyship status whenever:
 (a) pursuant to contract (the "secondary obligation"), an obligee has recourse against a person (the "secondary obligor") or that person's

the relationship between *C* and *S* satisfies this functional definition.¹⁰⁷ *D* is entitled to only one full performance with respect to the obligation owed by *C* but has a right of recourse against both *S* and *C*.¹⁰⁸ As between *S* and *C*, *C*, who received the value given by *D* for the note, rather than *S*, should perform the engagement to pay. Consequently, the relationship between *D*, *C*, and *S* is a suretyship one within Section 1 of the *Restatement*.¹⁰⁹ The rules and principles of the general law of suretyship apply when determining the rights and obligations of parties to the instrument regarding any action taken by *D* against or in relationship to *C* as a principal obligor or indorser.¹¹⁰ Unless *S* agrees that the provisions of Revised Article 3 will govern its obligation, *D* must consult the general law of suretyship¹¹¹ when contemplating an action such as extending the time of payment or otherwise modifying an obligation that might adversely affect *S*'s rights as a secondary obligor of *C*.¹¹² But, *D* must consult Revised Article 3 with respect to *B* and *S*'s rights as accommodation parties for *A* and *C*'s rights as an indorser of *A*'s obligation.¹¹³ To further complicate the matter, the instrument has multiple accommodation parties with rights among them. An action by *D*, such as releasing either of the accommodation parties or granting either an extension in time, may adversely affect the rights of the other, limiting *D*'s right of recourse against the accommodation party whose rights have been impaired.¹¹⁴

property with respect to the obligation (the "underlying obligation") of another person (the "principal obligor") to that obligee. . . .

RESTATEMENT (THIRD), *supra* note 45, § 1(a).

107. *See id.*

108. *See id.* §§ 1(1)(b), 1(2)(a)-(b).

109. *See id.*; *see also* U.C.C. § 3-419(a) cmt. 3 (1990) (stating that an accommodation party is always a surety).

110. *See* U.C.C. § 3-419 cmt. 3 (1990).

111. Alabama, California, Georgia, Louisiana, Montana, North Dakota, Oklahoma, South Dakota, and Texas have general suretyship statutes. *See* ALA. CODE §§ 8-3-1 to 8-3-42 (1993); CAL. CIV. CODE §§ 2787-2847 (West 1994); GA. CODE ANN. §§ 10-7-22 to 10-7-57 (1994); LA. CIV. CODE ANN. art. 3047-3070 (West 1994); MONT. CODE ANN. §§ 28-11-401 to 28-11-420 (1997); N.D. CENT. CODE §§ 22-03-01 to 23-01-15 (1997); OKLA. STAT. ANN. tit. 15, §§ 371-385 (West 1993); S.D. CODIFIED LAWS §§ 56-2-1 to 56-2-17 (Michie 1997); TEX. BUS. & COM. CODE ANN. §§ 34.01-34.05 (West 1999).

112. *See* RESTATEMENT (THIRD), *supra* note 45, §§ 40-41.

113. *See* U.C.C. § 3-415 (1990). Refer to note 98 *supra*.

114. *See* RESTATEMENT (THIRD), *supra* note 45, §§ 52-61; U.C.C. § 3-116 (1990).

(2) *D Releases C*:

a. *The Restatement View.* *D* releases *C* and seeks to recover from *S*. *S* (a secondary obligor) has rights of recourse against *C* (the principal obligor) including reimbursement, subrogation, and the right to insist on *C*'s duty of performance.¹¹⁵ *D*'s release of *C* impairs *S*'s right of recourse if *D* failed to expressly preserve *D*'s right of recourse against *S* and *S*'s rights against *C*.¹¹⁶ If *D* preserves recourse for both *S*, the secondary obligor, and itself, *S*'s rights against *C* are maintained as though the release did not occur.¹¹⁷ Failure to preserve recourse against both *C* and *S* will release and discharge *C* not only from its duties to *D* but also from any corresponding duties to *S*.¹¹⁸ Contrary to the prior rule under the *Restatement of Security*¹¹⁹ and former Article 3,¹²⁰ the *Restatement* permits the obligee, *D*, to release *C* and preserve *D*'s right of recourse against *S* without preserving *C*'s corresponding duties to *S*.¹²¹ The obligee's rights against the secondary obligor may be preserved by implication from the language of the release or circumstances that indicate an intent to recover from *S* even in the absence of express preservation.¹²² For example, if the release occurs when the principal obligor is insolvent or because the principal obligor lacks the capacity to contract, two primary reasons an obligee seeks a secondary obligation to prevent loss, preservation of recourse is implied.¹²³ The effect of this exception is to create a safety net for the obligee who fails to preserve recourse in the two instances when the failure is most likely to occur—insolvency and incapacity of the principal obligor.

At first blush, this ability of the obligee to release the principal obligor while preserving recourse against the secondary obligor appears to result in unfairness to the secondary obligor with the potential for abuse and even collusion between the obligee and the principal obligor. However, *Restatement* Section 39 permits a discharge of the

115. See RESTATEMENT (THIRD), *supra* note 45, § 38.

116. See *id.*

117. See *id.* § 38(2).

118. See *id.* § 38.

119. See RESTATEMENT OF SECURITY § 122(b) & cmt. a (1941).

120. See U.C.C. § 3-606(2) (1989).

121. See RESTATEMENT (THIRD), *supra* note 45, § 39(b)(ii) & cmt. d.

122. See *id.*

123. See *id.* § 39 cmt. d, illus. 4, 6; see also *id.* § 34 cmt. c (indicating that the lack of capacity to enter into an obligation is one of the reasons an obligee insists on having a secondary obligor).

secondary obligor if the release of the principal obligor causes the secondary obligor loss.¹²⁴ But this right to a discharge for loss caused by the release of the principal obligor when the obligee fails to preserve the secondary obligor's recourse carries with it the burden of persuasion on the fact and amount of loss for the professional surety or corporate officer or owner.¹²⁵ Despite its goals of avoiding a windfall to either party through adherence to traditional rules, facilitating receipt of the "benefit bargained for" without overcompensation, and achieving parity among the parties, in the context of release, the *Restatement* scale is tilted in favor of the obligee. The obligee may release the principal obligor and retain rights against the secondary obligor, who must bear the burden of establishing its loss, unless the loss is "not reasonably susceptible of calculation or requires proof of facts that are not ascertainable,"¹²⁶ without the imposition of any corresponding duty on the obligee to notify the secondary obligor of the release.¹²⁷ Although the *Restatement* acknowledges or "tips its hat" at the need for notice, none is required.¹²⁸ Surely, the secondary obligor must introduce evidence of circumstances, including its diligence in attempting to acquire facts of the principal obligor's assets or financial status at the time of the release or expert testimony to establish its inability to calculate or to ascertain the amount of loss but not the fact of loss,¹²⁹ before it is discharged from its obligation to perform. Notice of the principal obligor's release would, at the very least, assist the secondary obligor in its effort to ascertain facts and to acquire and/or preserve evidence of the principal obligor's assets or ability to perform at the time of the release.¹³⁰

Thus, under the *Restatement*, if *D* releases *C*, expressly preserving both *D*'s and *S*'s right of recourse, *C* is released from its obligation to *D* but not from its obligation to *S*.¹³¹ Further, *S*

124. *See id.* § 39(c)(ii).

125. *See id.* § 49(2)(a)(i) & cmt. b.

126. *Id.* § 49(3)(b).

127. *See id.* § 38 cmt. b.

128. *See id.*

129. *See id.* § 49(3) (shifting the burden of persuasion to the obligee once the secondary obligor demonstrates the prejudice caused by the impairment of recourse and that the amount of loss is not reasonably susceptible of calculation or requires proof of facts not determinable).

130. *See, e.g.,* U.C.C. § 2-515 (1999) (permitting, under Article 2, any party, upon reasonable notification to the other, to inspect, sample, and test goods to assist in ascertaining the facts and preserving evidence).

131. *See* RESTATEMENT (THIRD), *supra* note 45, § 39(a).

must perform the secondary obligation.¹³² If *D* releases *C* and neither the language nor the circumstances indicate an intent to preserve *D*'s rights against *S*, then both *C* and *S* are discharged.¹³³ Where the language or circumstances indicate an intent to preserve *D*'s rights against *S* without preservation of *S*'s rights against *C*, *S* is discharged to the extent of the loss resulting from *D*'s impairment of recourse against *C*—if *S* carries its burden of persuasion.¹³⁴

b. Revised Article 3's Perspective on Release. Contrary to the position of the *Restatement* and Former Article 3,¹³⁵ release of *C* by *D* without reserving rights neither discharges the holder's rights against the accommodation party nor the accommodation party's rights against the accommodated party.¹³⁶ *D*'s rights against *S* are preserved by Section 3-605(b), and *S*'s right of recourse is preserved by Section 3-419(e).¹³⁷ Revised Article 3 eliminates the necessity of reserving rights.¹³⁸

What is gained by these changes in suretyship law? Those creditors who may have forgotten to reserve their rights upon release of the accommodated party are protected.¹³⁹ However, the inherent unfairness that existed under the former rule of reservation of rights is intensified. First, under the reservation of rights doctrine, the creditor had an obligation to use words like: "I reserve my rights against the accommodation party [surety]."¹⁴⁰ The accommodated party might believe that the release resulted in a complete discharge of her obligation. Much to her surprise, the debtor would discover that neither she or the surety were off the hook—both were still obligated.¹⁴¹ Rather than assume that

132. See *id.* § 39(b).

133. See *id.* § 39 cmt. d.

134. See *id.* § 39(c)(ii); see also *id.* § 49(2)(a) (listing the occasions upon which the secondary obligor has the burden of persuasion in showing a loss caused by an act of the obligee).

135. See *id.* § 39(a)-(b)(i); U.C.C. § 3-606(1)(a) (1989).

136. See U.C.C. § 3-605(b) (1990); see also *id.* § 3-604(a) (describing how a discharge can take place).

137. See *id.* §§ 3-605(b), 3-419(e).

138. See *id.* § 3-605 cmt. 3 (indicating that Section 3-605 eliminates the necessity for the obligee to formally reserve rights against the accommodation party in order to seek recourse from that party).

139. See, e.g., *id.* (noting that the creditor's recourse against sureties and accommodation parties is preserved whether the creditor formally reserves its rights or not).

140. Refer to notes 94-95 *supra* and accompanying text (detailing the reservation of rights doctrine and how an accommodation party can reserve their rights against the accommodated party).

141. See American Law Institute, National Conference of Commissioners on Uniform State Laws, Commercial Code (Group No. 1), Notes and Comments to Tentative Draft No.2—Article III, ¶ (a), at 108 (unpublished draft) (Apr. 25, 1947)

the statement meant she was no longer obligated but that the surety was, the curious debtor might ask: "What does this mean?" At least from the words, whether oral or written, the debtor had some notice that the obligation was not completely nullified and that the creditor's rights against the accommodation party remained.¹⁴²

Second, the creditor is permitted to substantially modify the contractual relationship among the parties and to change the risk assumed by the accommodation party without its consent.¹⁴³ With the revision, the accommodated party does not know of its continuing liability or the accommodation party's liability; moreover, the accommodation has neither the opportunity to consent nor notice of a change in the contractual risk undertaken when its engagement was made on the instrument.¹⁴⁴ The concerns of the 1947 drafting committee still remain.¹⁴⁵

(3) *D Releases A and B, but not C*

*a. Effect on Rights Against A, the Accommodated Party*¹⁴⁶

Under Revised Article 3, neither *S*, the accommodation party,¹⁴⁷ nor *C*, the indorser¹⁴⁸, are discharged upon release of *A*, the accommodated party.¹⁴⁹ No preservation or reservation of

[hereinafter Tentative Draft No.2].

142. See RESTATEMENT (THIRD), *supra* note 45, § 39 cmt. c (arguing that if the obligee releases the principal obligor while preserving the secondary obligor's recourse, then the principal obligor cannot reasonably expect its duties to be discharged with respect to the secondary obligor).

143. See U.C.C. § 3-605(d) (1990) (noting the effects of a material modification other than an extension in time).

144. See Jenkins, *supra* note 74, at 661-64 (discussing the unfairness that existed under former law and a modern theoretical justification for notice to the accommodation party).

145. See Tentative Draft No.2, *supra* note 92, at 108 (reporting the Chief Reporter and the Advisers' feeling that the reservation of rights was a trap and should be discarded).

146. Refer to notes 99-100 *supra* and accompanying text (discussing *A*'s status as the sole accommodated party).

147. Refer to note 103 *supra* and accompanying text (noting that *S* is the accommodation party because *S* incurs liability without directly benefiting from the value given when the instrument was issued).

148. Refer to note 113 *supra* and accompanying text (discussing *C*'s role as an indorser of *A*'s obligation).

149. See U.C.C. § 3-605(b) (1990). Refer to notes 99-100 *supra* and accompanying text (discussing *A*'s status as the sole accommodated party).

rights is necessary to prevent the discharge of the accommodation party¹⁵⁰ or to preserve *S*'s rights against *A*.¹⁵¹

All indorsers are not accommodation parties, but those that are not, are guarantors or secondary obligors. *C* is an indorser who signed without limiting its liability on the instrument, that is, *C* did not indorse "without recourse."¹⁵² Thus, *C* is deemed under the comments to Section 3-605 to be a guarantor of payment and is a surety¹⁵³ entitled to all the rights inherent in that status.¹⁵⁴ Although the accommodation party, who is a surety, has its right of recourse preserved under Section 3-419, an indorser, who is a surety but who is not an accommodation party, does not have its right of recourse preserved by statute under Revised Article 3.¹⁵⁵ With a deliberate, forced, or intentional reading of the definition of "accommodation party" in Section 3-419, an indorser could be held to be an accommodation party, and thus, would be entitled to the right of recourse preserved by statute against the accommodated party.¹⁵⁶

An accommodation party is one (1) who signs the instrument, (2) with the purpose of incurring liability on the instrument, (3) without being a direct beneficiary of the value given for the instrument.¹⁵⁷ Any indorser who does not sign "without recourse" will satisfy the requirements of (1) and (2) because he or she will sign the instrument with the purpose of incurring liability on the instrument.¹⁵⁸ It is the third requirement, "without being a direct beneficiary of the value given for the instrument," that creates difficulty.¹⁵⁹ If this last requirement means without being a direct beneficiary of the value given "when the instrument was issued," all indorsers will satisfy this requirement.¹⁶⁰ If the requirement means without

150. See *id.* § 3-605 cmt. 3.

151. Refer to notes 135-38 *supra* and accompanying text.

152. An indorser may sign "without recourse" thereby disclaiming contractual liability on the instrument but not any transfer or presentment warranties. See U.C.C. § 3-415(b) (1990).

153. See *id.* § 3-605, cmt.1.

154. See *id.*

155. See *id.* § 3-419(e) & cmt. 3.

156. See *id.* §§ 3-419(b)-(e) (noting that an accommodation party can sign as an indorser and is entitled to reimbursement from the accommodated party).

157. See *id.* § 3-419(a).

158. See *id.* § 3-204(a) (defining an indorsement as a signature made on an instrument to incur liability by the indorser).

159. *Id.* § 3-419(a).

160. See *id.* § 3-419 cmt. 1 (defining an accommodation party as a party who signs an instrument for the benefit of the accommodated party, at the time the value is obtained by the accommodated party or later, without receiving direct benefit from the value obtained).

being a direct beneficiary of the value given for the instrument "at any time," then indorsers who subsequently negotiate the instrument for value will not satisfy this requirement and should not be held to be accommodation parties. The second construction is the more reasonable and plausible construction. The first construction would unduly limit accommodation party status to those who are parties to the instrument at issuance and negate the possibility of post-issuance accommodation should the circumstances justify the addition of an accommodation party. Consequently, indorsers who are not anomalous indorsers or who are not otherwise shown to have signed to incur liability without receiving a direct benefit are not accommodation parties with rights preserved by statute, but, are sureties under the comment to Section 3-605—at least in those jurisdictions that enacted Revised Article 3 before PEB Commentary No. 11.¹⁶¹

Despite failing the test of Section 3-419 for accommodation party status, an indorser generally satisfies the functional definition of a secondary obligor under the *Restatement*.¹⁶² The holder or obligee has recourse against the indorser because of the indorser's contractual obligation on the instrument;¹⁶³ the obligee is not entitled to the performance of the maker or drawer to the extent that the indorser has performed and, conversely, is not entitled to the performance of the indorser to the extent the maker or drawer has performed.¹⁶⁴ As between the maker or drawer and the indorser, the maker or drawer should bear the cost of performance.¹⁶⁵ The indorser who is not an accommodation party must look to the general law of suretyship for its suretyship rights.¹⁶⁶

Unlike Revised Article 3, the general law of suretyship, as reflected in the *Restatement*, requires an express preservation of the indorser's rights, or the indorser is discharged.¹⁶⁷ Thus, *D*'s release of *A* discharges *D*'s rights against *A* and *C*'s rights against *A* unless the release contained an express preservation of

161. See *id.* § 3-605 cmt. 1 (applying surety status to indorsers who are not accommodation parties). Refer to note 39 *supra* and accompanying text (listing those jurisdictions that adopted Revised Article 3 before PEB Commentary No. 11).

162. See RESTATEMENT (THIRD), *supra* note 45, § 1 & cmts. b, h (explaining that a secondary obligor means being answerable in some manner to the obligee even if the secondary obligation is not identical to the principal obligation).

163. See U.C.C. § 3-415(a)-(b) (1990).

164. See *id.* § 3-415(a).

165. See *id.* §§ 3-412, 3-414(b).

166. See *id.* § 3-419 cmt. 3.

167. Refer to notes 94-98 *supra* and accompanying text (discussing the obligee's need to preserve recourse).

C's rights.¹⁶⁸ Furthermore, in the absence of an express preservation and unless the circumstances or language indicate D's intent to enforce the instrument against C, C is also discharged from its indorser engagement.¹⁶⁹

*b. Effect on Rights Against B, the Accommodation Party—
Multiple Sureties: General Suretyship Law & Revised Article 3*

B and S are accommodation parties¹⁷⁰ and C, as an indorser, is a guarantor of payment and a secondary obligor.¹⁷¹ All are sureties with respect to the same underlying obligation, A's engagement to pay. Section 3-116 grants a right of contribution to parties with the same liability on an instrument.¹⁷² However, if in using the phrase the drafters intended "same liability" to be limited to the concept of the type of engagement made, then B and S do not have the "same liability" although both are accommodation parties.¹⁷³ Furthermore, although S and C are both indorsers, the text of Section 3-116 suggests that S as an anomalous indorser, and C as an indorser in the chain of title, should not be treated under Section 3-116 as having the "same liability."¹⁷⁴ This conclusion is consistent with the parties' intentions at the time S's engagement was made. Although the case is not presented here, "same liability" might reasonably entail consideration of the facts and circumstances existing at the time of an engagement beyond the type of engagement made in order to further distinguish among classes of multiple accommodation makers, such as cosureties and subsureties.¹⁷⁵ Here, however, all are sureties: B signed as an accommodation maker; S signed as an accommodation indorser; and C is an indorser. Despite this, they do not have the "same liability" on the instrument. Further, because C is not an accommodation

168. See RESTATEMENT (THIRD), *supra* note 45, § 39(a).

169. See *id.* § 39(b).

170. Refer to note 101 *supra* and accompanying text (declaring B an accommodation party because B incurred liability without direct benefit and conferring the same status to S despite S's engagement after the initial issuance of the instrument).

171. Refer to note 154 *supra* and accompanying text (noting that under Section 3-605, comment 1, C is a guarantor and a surety).

172. See U.C.C. § 3-116 (1990).

173. Refer to notes 101-03 *supra* and accompanying text (distinguishing S from B by the fact that S's engagement arose after the instrument was issued).

174. See U.C.C. § 3-116 cmt. 2 (1990) (observing that indorsers usually do not have joint and several liability unless both are anomalous indorsers or the instrument is payable to two payees).

175. See RESTATEMENT (THIRD), *supra* note 45, § 53 & cmts. g, h.

party, general suretyship law must govern the relationship among the three sureties.¹⁷⁶

As multiple sureties to the same obligation, rights of recourse exist among the parties.¹⁷⁷ The *Restatement* recognizes two classes of relationships between multiple sureties: co-suretyship and subsuretyship.¹⁷⁸ In the absence of an express or implied agreement among the sureties, a presumption arises that the relationship is one of co-suretyship.¹⁷⁹ If the multiple sureties are co-sureties, each should perform part of the secondary obligation.¹⁸⁰ Performance by one of the sureties of more than its contributive share entitles it to contribution from the others.¹⁸¹ On the other hand, if circumstances, including an express agreement, establish that one, the principal surety, should perform rather than the one or more of the others, the subsurety(ies), the relationship among them is one of subsuretyship.¹⁸² If the relationship is one of subsuretyship, the principal surety and the subsurety have the same relationship and rights as exist between the principal obligor and the secondary obligor.¹⁸³ Consequently, the subsurety is entitled to reimbursement or restitution¹⁸⁴ and has a right to demand performance by the principal surety.¹⁸⁵

Although no agreement exists among our three hypothetical parties, circumstances establish a subsuretyship relationship among them. If *S* lacked notice of *B*'s status as an accommodation party at the time of *S*'s engagement, *S* could reasonably believe, from *B*'s engagement as a co-maker, that *B* was a principal obligor with an obligation to perform the

176. See U.C.C. § 3-419 cmt. 3 (1990); see also U.C.C. § 1-103 (1999) (stating that the U.C.C. is supplemented by the principles of law and equity).

177. See RESTATEMENT (THIRD), *supra* note 45, §§ 52-53 (pointing out that the relationship between multiple sureties, either being co-sureties or principal and secondary subsureties, determines the parties' relative rights and duties).

178. See *id.* § 53(1).

179. See *id.* § 53(3).

180. See *id.* § 53(2).

181. See *id.* § 55.

182. See *id.* § 53(2); see, e.g., *Johnson v. Guerra*, 26 U.C.C. Rep. Serv. 2d (CBC) 178, 181 (Va. Cir. Ct. 1995) (finding a subsuretyship relationship on the basis of circumstances).

183. See RESTATEMENT (THIRD), *supra* note 45, § 59.

184. See, e.g., *Swanson v. Krenik*, 868 P.2d 297, 299 (Alaska 1994) (stating that a co-suretyship relationship, as to the holder, does not modify the subsuretyship relationship based on circumstances); *Schinnell v. Doyle*, 496 P.2d 566, 570 (Wash. Ct. App. 1972) (affirming that the seller's role in negotiating a loan for the buyer and in being a surety of a specific obligation resulted in the seller being a principal surety to ten general indebtedness guarantors). Refer to notes 61-67 *supra* and accompanying text (distinguishing reimbursement and restitution).

185. See RESTATEMENT (THIRD), *supra* note 45, § 21.

instrument.¹⁸⁶ In addition, even assuming that *S* had knowledge of *B*'s status as an accommodation party at the time of *S*'s engagement, if *S* reasonably believed that *B*, a prior secondary obligor, assumed a greater obligation to perform—the economic relationship of a principal surety—then *S* is a subsurety, and *B* is the principal surety.¹⁸⁷ Having made an accommodation engagement without the expectation of another with whom it would share responsibility of performing *A*'s obligation, it would be unreasonable for *B* to expect to share the obligation with *S*.¹⁸⁸ Hence, *S* should be treated as a subsurety with all the rights that a secondary obligor has against its principal obligor.¹⁸⁹

As previously illustrated, *S* is a secondary obligor to *C*'s engagement on the instrument.¹⁹⁰ *C*'s status as a surety does not change the nature of the relationship between these two. As multiple sureties of *A*'s obligation, *B* is the principal surety in its relationship with *C* and *S*, and *C* is the principal surety in its relationship with *S*.

As a subsurety, *S*, like the secondary obligor in its relationship with the principal obligor, is entitled to have *B* bear the cost of the performance owed to *D*.¹⁹¹ Assuming *D* preserved its rights against *S* with express language or by conduct indicating an intent to recover from *S*,¹⁹² *D*'s release of *B* without preserving *S*'s right of recourse against *B* impairs the fundamental right of the subsurety.¹⁹³ Releasing *B* without

186. See *id.* § 53(4)(a)(i) & cmt. h.

187. See *id.* § 53(4) & cmt. g; see also *Gigliotti v. Gigliotti*, 406 A.2d 614, 615 (Conn. Super. Ct. 1979) (holding the defendant not liable for contribution because the defendant had a reasonable belief that her former husband was the principal borrower); *Kurzman v. Steir*, 426 N.E.2d 165, 167 (Mass. App. Ct. 1981) (stating that there was no basis in fact or law to lead the defendant to believe that another secondary obligor was the principal obligor); *Cook v. Crabtree*, 733 S.W.2d 67, 69-70 (Tenn. 1987) (confirming the defendant's belief that she was a subsurety).

188. See RESTATEMENT (THIRD), *supra* note 45, § 53 cmt. g (affirming that if when a secondary obligor assumes its obligation without any assurance that an extra secondary obligor would also be liable, any additional secondary obligor, who mistakenly but reasonably believes the first secondary obligor is the principal surety, becomes a subsurety).

189. See *id.* § 59.

190. Refer to notes 106-07 *supra* and accompanying text.

191. See RESTATEMENT (THIRD), *supra* note 45, § 54 & cmt. a; see also *Cook*, 733 S.W.2d at 69 (discussing the relationship between the principal surety and the subsurety).

192. See RESTATEMENT (THIRD), *supra* note 45, § 39(b) & cmt. d.

193. See *id.* § 54 cmt. a (indicating that the right of one secondary obligor or subsurety to have the principal obligor or subsurety bear all or part of the performance is the fundamental right of suretyship, and that an obligee can impair this right by preventing one secondary obligor from causing another secondary obligor to bear the cost of performance).

preserving *S*'s rights eliminates *B*'s duties of performance and reimbursement.¹⁹⁴ *D*'s release also negates the right of subrogation because *D* no longer has rights against *B*.¹⁹⁵ Thus, the release discharges *S* unless the release does not result in loss for *S*.¹⁹⁶ If *B* is insolvent, lacks assets, or is otherwise judgment proof at the time of the release, *S* does not suffer loss from *B*'s release.¹⁹⁷ Under these circumstances, the likelihood of *S*'s recovery against *B* in the absence of the release is negligible.

(4) *B* Releases *A*

Section 3-604(a) permits a person entitled to enforce an instrument to discharge the obligation of a party to pay the instrument.¹⁹⁸ *B*'s discharge of *A* might occur by *B*'s surrendering of the instrument to *A*, canceling the instrument, attaching *A*'s signature on the instrument, or through adding words to the instrument such as "Paid."¹⁹⁹ Alternatively, *B* might agree to discharge or renounce her rights against *A* in a signed writing. If made prior to *B*'s acquiring the instrument, the agreement between *A* and *B* would not adversely affect *A*'s obligation to perform.²⁰⁰ However, Section 3-604 only permits one entitled to enforce the instrument²⁰¹ to discharge the obligation of a party to the instrument.²⁰² Furthermore, if the agreement was made when the instrument was issued, *B* was not one entitled to enforce the instrument but was an accommodation party, and thus, such an agreement cannot adversely affect the rights of one entitled to enforce.²⁰³

194. See *id.* § 39(a).

195. See *id.* § 39 cmt. f.

196. See *id.* § 39(c)(ii).

197. See *id.* § 39 cmt. f.

198. See U.C.C. § 3-604(a) (1990).

199. See *id.*

200. See *id.* § 3-604(b) (declaring that cancellation under subsection (a) will not affect the rights of a party derived from the indorsement).

201. Section 3-301 provides that a "[p]erson entitled to enforce' an instrument means (i) the holder of the instrument, (ii) a non-holder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 3-309 or 3-418(d)." *Id.* § 3-301.

202. See *id.* § 3-604(a).

203. See *id.* § 3-117 (indicating that the obligation of a party to pay the instrument may only be released by a separate agreement if the instrument is issued in reliance on the agreement); *id.* § 3-601(b) (noting that discharge of an obligation does not affect the rights of a holder in due course who did not have notice of the discharge).

B will only satisfy the requirements of Section 3-604 if she is: (1) a holder, the instrument has been properly indorsed and delivered to her;²⁰⁴ (2) a non-holder in possession of the instrument who has the rights of a holder because she is in possession without proper indorsement as a transferee²⁰⁵ or has a right to enforce because of subrogation or legal succession,²⁰⁶ or possibly because she is a remitter,²⁰⁷ a position that is not relevant here; or (3) because she has a non-possessory right to enforce the instrument because it has been lost, destroyed, or stolen.²⁰⁸ Here, *B* will only acquire the instrument upon payment of her obligation as an accommodation party to the holder, *D*, or in performing the principal surety obligation owed to one or both of the subsureties.²⁰⁹

a. The Effect of B's Acquisition and Release of A—Former Article 3. Under former Article 3, *B*'s possession of the instrument is treated as a reacquisition under Section 3-208²¹⁰ and all intervening parties, *C* and *S*, are discharged.²¹¹ This result is consistent with the suretyship relationship between these parties.²¹² As prior analysis illustrated, both *C* and *S* are

204. See *id.* § 3-301 (noting that a person entitled to enforce an instrument can be the holder of the instrument); see also § 3-604(a) (permitting only parties entitled to enforce an instrument to exercise the right to discharge an obligation of a party).

205. See *id.* § 3-203(c) (permitting a transferee for value, who does not become a holder because of the lack of a proper indorsement by the transferor, to require the unqualified indorsement of the transferor).

206. See *Smathers v. Smathers*, 239 S.E.2d 637, 638-39 (N.C. Ct. App. 1977) (holding that the plaintiff's physical possession of the instrument resulted in transferee status, but not holder status, despite possession of the indorsement); see also U.C.C. § 3-301 & cmt. (1990) (suggesting that a non-holder who can enforce an instrument includes those who gain the rights of subrogation or anyone who is a successor to the holder).

207. Refer to note 25 *infra* and accompanying text (listing authorities that discuss the remitter's right to enforce an instrument).

208. See U.C.C. § 3-309(a) (1990) (permitting a person not in possession of an instrument to enforce the instrument if the person possessed the instrument and was entitled to enforce it before it was lost, if the loss was not due to transfer or lawful seizure and if the person cannot gain possession of the instrument because it was destroyed, lost, or in the wrongful possession of another who cannot be found or served with process). Revised Article 3 also empowers one from whom the drawee bank recovers a mistaken payment or revokes acceptance of an instrument to enforce the instrument. See *id.* § 3-418(d). If the instrument was previously honored, the party disgorging the prior payment will no longer have the instrument. See *id.* The recovery by the drawee bank of payment is treated as a dishonor satisfying the condition precedent to imposition of liability on the drawer or indorser. See *id.*

209. Refer to notes 178-85 *supra* and accompanying text.

210. See U.C.C. § 3-208 (1989).

211. See *id.*

212. Refer to notes 104-05 *supra* and accompanying text (discussing the suretyship relationship among *B*, *C*, and *S*).

subsureties in their relationship with *B*.²¹³ No harm results under the operation of the rule of reacquisition here. However, if an agreement existed between *B* and some subsequent party so that *B*, instead of the subsequent party, was in fact the subsurety, the rule of reacquisition would adversely affect *B*'s ability to enforce the instrument against the subsequent party.²¹⁴ *B*, however, might recover on her right to reimbursement or restitution but not on the instrument.²¹⁵

b. Effect of B's Acquisition and Release of A—Revised Article 3. Reacquisition, a rule of convenience that alleviates the necessity of acquiring indorsements to revest a prior party with title to the instrument, is defined in Section 3-207 of Revised Article 3.²¹⁶ Reacquisition occurs if the instrument is transferred to a former holder.²¹⁷ *B*, an accommodation party, was not a former holder in the hypothetical problem under consideration;²¹⁸ therefore, the reacquisition rule of Section 3-207 is inapplicable.²¹⁹ Furthermore, *B*'s right to enforce or negotiate the instrument results from her subrogation rights, which were acquired upon payment of the instrument.²²⁰

As an accommodation party, *B* is only entitled to enforce the instrument against the accommodated party,²²¹ *A*, or seek contribution from a co-surety.²²² Under the general law of

213. Refer to notes 182-85 *supra* and accompanying text (discussing the principal surety and subsurety relationship).

214. In this situation, *B* could not enforce the reacquired instrument against the subsequent party because intervening parties are discharged from their obligation to the reacquiring party. *See* U.C.C. § 3-208 (1989).

215. *See* U.C.C. § 1-103 (1999) (emphasizing that unless displaced by a specific provision of the UCC, the principals of law and equity supplement UCC provisions); *see also* RESTATEMENT (THIRD), *supra* note 45, § 59 cmts. b-c (declaring that when a subsurety performs the obligation, he has a reimbursement or restitution claim against the principal surety).

216. *See* U.C.C. § 3-207 & cmt. (1990) (explaining that in cases when the reacquisition is not a result of a negotiation and the instrument is not payable to the holder, Section 3-207 dispenses with the requirement to obtain the indorsement of the instrument).

217. *See id.* § 3-207.

218. Refer to note 101 *supra* and accompanying text (explaining that *B* signed the instrument as a maker who received no direct benefit of the value given and is, therefore, an accommodation maker).

219. *See* U.C.C. § 3-207 (1990).

220. *See id.* § 3-419(e) (stating that an accommodation party who pays the instrument is entitled to enforce the instrument against the accommodated party); PEB Commentary No. 11, *supra* note 37, at 3 (clarifying that the "right to enforce" in Section 3-419(e) effectively sets forth subrogation rights).

221. *See* U.C.C. § 3-419(e) (1990).

222. *See id.* § 3-116(b).

suretyship, *B*, in her relationship with *C* and *S*, is the principal surety to both because of the subsuretyship relationship.²²³ As the principal surety, *B* is the principal obligor and the subsureties are secondary obligors.²²⁴ The principal obligor has no right of recourse against the secondary obligor or subsurety.²²⁵ The principal surety bears the entire cost of performance as between the principal surety and subsurety.²²⁶ No party exists to whom *C* or *S* owe a duty of performance.²²⁷ Therefore, *B*'s release of *A* is within *B*'s right. Section 3-605, which has been problematic in other contexts, is not a problem here.²²⁸ After *B*'s acquisition of the instrument and discharge of *A* under Section 3-604, the indorser, *C*, and secondary obligor, *S*, no longer have liability on the instrument. Because neither owes a duty of performance to anyone, no party remains who has a right of recourse against these two.

(5) *S* Releases *A*

S is an accommodation party for *A*, a secondary obligor for *C*, and the subsurety for *B*.²²⁹ What impact if any occurs if *S*, after paying *D*, the holder, releases *A*, the accommodated party? Revised Article 3 applies to this action as it broadly asserts in Section 3-605(b) that the "[d]ischarge . . . of the obligation of a party . . . does not discharge the obligation of an indorser or accommodation party having a right of recourse against the discharged party."²³⁰ This discharge by *S* may occur without the preservation of *B*'s or *C*'s rights against *A*.²³¹ *B*'s rights as an accommodation party are preserved by Section 3-

223. Refer to note 213 *supra* and accompanying text (describing the nature of the subsuretyship relationship existing among *B*, *C*, and *S*).

224. See RESTATEMENT (THIRD), *supra* note 45, § 59.

225. See *id.* §§ 1 cmt. p, 61 cmt. a.

226. See *id.* § 59 cmt. a (explaining that because the relationship between the principal surety and the subsurety is the same as that between the principal obligor and secondary obligor, the principal surety ought to bear the entire cost of performance).

227. See U.C.C. § 3-207 (1990) (restating Section 3-208 of the 1989 UCC—intervening parties are discharged when prior party reacquires the instrument).

228. Refer to notes 135-45 *supra* and accompanying text (detailing the possible misunderstanding of the rights of the secondary obligor if the principal obligor is discharged).

229. Refer to notes 103, 107, & 189 *supra* and accompanying text (explaining the relationship of *S* to the other parties).

230. U.C.C. § 3-605(b) (1990).

231. See *id.* § 3-605 cmt. 3 (explaining that Section 3-605(b) eliminates the necessity of expressly reserving the right of recourse against an indorser or an accommodation party upon the discharge of the party).

419 but *C*'s rights against *A* are not preserved by statute.²³² *S*'s failure to preserve *C*'s rights against *A* discharges *A*'s obligation to *C* under the general law of suretyship,²³³ the law that governs *C*'s rights as a guarantor of payment.²³⁴ However, because *B*'s obligation remains, *C* has recourse against *B* should *S* recover from *C*.

S and *B* have a subsurety relationship; Revised Article 3 does not address issues relating to those who have a subsurety relationship and, therefore, the general law of suretyship should supplement.²³⁵ Under the *Restatement*, the relationship among the principal obligor, the principal surety, and the subsurety is treated identically to that among the principal obligor, the secondary obligor, and the obligee.²³⁶ The suretyship defenses of a secondary obligor are available to the principal surety, *B*, for action taken by the subsurety, *S*, which impairs the principal surety's right of recourse.²³⁷

C. Recommendation

In revising the suretyship rules of Article 3, the drafting committee created a quagmire for the creditor when the transaction involves multiple parties. On its face, Revised Section 3-605(b) favors creditors by facilitating retention of the surety.²³⁸ Lulled by the text of Revised Article 3, a creditor may engage in conduct that minimizes its ability to recover. Consequently, an obligee will always preserve rights to avoid an inadvertent discharge of the accommodation party or other surety. Thus, any apparent benefit of Section 3-605(b) is lost. The potential confusion and inconsistent results under Revised Article 3, when substantively identical rights on the same instrument are adversely affected, justify revising Revised Section 3-605. Revised Article 3 should adopt the rules of the *Restatement* to implement the goals of the UCC as stated in Article 1: "to simplify, clarify and modernize the law governing commercial transactions... [and]... to make uniform the law among the various jurisdictions."²³⁹

232. See *id.* § 3-419. Refer to note 153-54 *supra* and accompanying text.

233. See RESTATEMENT (THIRD), *supra* note 45, § 39(a).

234. Refer to note 153 *supra* and accompanying text (discussing *C*'s position as a guarantor of payment).

235. Refer to note 186-89 *supra* and accompanying text.

236. See RESTATEMENT (THIRD), *supra* note 45, § 59 & cmt. a.

237. See *id.* § 54.

238. Refer to notes 135-38 *supra* and accompanying text (noting that the creditor may retain rights against an accommodation party even if he or she does not expressly reserve these rights).

239. U.C.C. § 1-102(a), (c) (1999).

III. OTHER MINOR ADJUSTMENTS

A. *The Co-Maker's Rights Clarified*

While creating havoc in some of the suretyship principles, Revised Article 3 clarifies one point of confusion under former law—the co-maker's right to contribution. Several jurisdictions, notably Texas, took the position that a co-maker was not a surety and, therefore, was not entitled to use the suretyship defenses or to contribution if it performed more than its ratable share of the obligation.²⁴⁰ Revised Article 3 rectifies the unfairness of this former position. Section 3-116 deems those with the same liability as jointly and severally liable and grants a right of contribution between them.²⁴¹ Read in conjunction with the suretyship discharge rule of Section 3-605(b), Section 3-116 preserves the right of recourse of any remaining joint and several obligor in the event of the release or discharge of the others.²⁴² Consistent with the recognition of a co-maker's right to contribution, Revised Article 3 recognizes the increased risk to a co-maker when an obligee impairs the value of an interest in collateral given to secure the obligation of the other co-maker.²⁴³ Section 3-605(f) authorizes a discharge to the extent of the increased cost of the resulting performance for the one jointly and severally liable from the impairment of the interest.²⁴⁴ The

240. See, e.g., *Hooper v. Ryan*, 581 S.W.2d 237, 238 (Tex. Civ. App.—Waco 1979, no writ) (holding that Section 3-606 applies to sureties but not to co-makers). *But see United Counties Trust Co. v. Podvey*, 389 A.2d 515, 520 (N.J. Super. Ct. Law Div. 1978) (holding co-makers of a note to be sureties who were discharged by Section 3-606).

241. See U.C.C. § 3-116 (1990). Section 3-116 provides:

(a) Except as otherwise provided in the instrument, two or more persons who have the same liability on an instrument as makers, drawers, acceptors, indorsers who indorse as joint payees, or anomalous indorsers are jointly and severally liable in the capacity in which they sign.

(b) Except as provided in Section 3-419(e) or by agreement of the affected parties, a party having joint and several liability who pays the instrument is entitled to receive from any party having the same joint and several liability contribution in accordance with applicable law.

(a) Discharge of one party having joint and several liability by a person entitled to enforce the instrument does not affect the right under subsection (b) of a party having the same joint and several liability to receive contribution from the party discharged.

Id.

242. See *id.* § 3-116(c).

243. See *id.* § 3-605(f).

244. See *id.* § 3-605(f). Under Former Article 3, no guidance was given on

discharge is limited by the co-maker's right of contribution, or the extent to which the collateral secured the other's obligation of performance; in any event, discharge should not exceed the right of contribution.²⁴⁵

Finally, Revised Section 3-605(f) resolves a potential problem that may occur when the holder lacks notice that an apparent co-maker is in fact an accommodation maker. Should an impairment of the collateral result, Section 3-605(f) provides that the undisclosed accommodation maker is entitled to discharge only to the extent of a right of contribution, rather than the right of reimbursement that an accommodation party is otherwise entitled.²⁴⁶ Thus, the apparent co-maker is assigned the loss that results from the non-disclosure of the true nature of his obligation on the instrument.²⁴⁷ The effect of this clause of Subsection (f) cannot be gleaned from the language of the text. Only upon review of the comments is the significance of this clause apparent.²⁴⁸

B. The Issuer & Remitter: A Neglected Concern

The drafters of Revised Article 3 sought to clarify two somewhat related concerns. First, the issuance of an instrument is defined as the "first delivery of an instrument by the maker or drawer . . . for the purpose of giving rights on the instrument to any person,"²⁴⁹ and second, the remitter is defined as "a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser."²⁵⁰ Generally, a remitter purchases a cashier's check, teller's check, money order, or traveler's check from an institutional issuer and

computing the extent of impairment. See U.C.C. § 3-606(1)(b) (1989) (declaring that a party is discharged to the extent a holder "unjustifiably impairs" the collateral but not defining "impairs"). Though somewhat cryptic, Revised Article 3 provides two methodologies for measuring the extent of impairment. See U.C.C. § 3-605(e) (1990) (stating that the value of an interest in collateral is impaired to the extent "the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting [the] discharge," or "the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest").

245. See U.C.C. § 3-605(f) & cmt. 7 (1990).

246. See *id.* § 3-605 cmt. 7 (explaining that under Section 3-605(f) an unknown accommodation party is treated as a co-maker with the right of contribution rather than an accommodation party with a right of reimbursement); *id.* § 3-419(c) (stating that an accommodation party who pays an instrument is entitled to reimbursement from the accommodated party).

247. See *id.* § 3-605 cmt. 7.

248. See *id.*

249. *Id.* § 3-105(a).

250. *Id.* § 3-103(a)(11).

does not thereby become a holder.²⁵¹ In response to increasing concern about the rights of a remitter,²⁵² the drafters redefined negotiation and transfer to exclude the issuance of an instrument. Revised Section 3-201(a) provides that "Negotiation" means a transfer of possession, whether voluntary or involuntary, of an instrument by a person *other than the issuer* to a person who thereby becomes its holder.²⁵³

Transfer is distinguished from negotiation as the delivery of an instrument "by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument."²⁵⁴ Consequently, when an instrument is issued neither a negotiation nor a transfer occurs under Revised Article 3. Other than obviating the possibility that the issuance of an

251. See *id.* § 3-201 cmt. 2.

252. See Gregory E. Maggs, *Determining the Rights and Liabilities of the Remitter of a Negotiable Instrument: A Theory Applied to Some Unsettled Questions*, 36 B.C. L. REV. 619, 620 (1995) (examining several questions concerning the rights of remitters under Revised Article 3 including whether a remitter can obtain a refund of the purchase price of an instrument, whether a remitter can enforce an instrument, whether a remitter makes transfer or presentment warranties, and whether a remitter has implied contractual liabilities); Jane E. Tobin, *Uniform Commercial Code Commentary, The Rights of a Remitter of a Negotiable Instrument*, 8 B.C. INDUS. & COM. L. REV. 260, 264-65 (1967) (discussing whether a personal money order should be treated the same as a personal check or cashier's check and whether a remitter has a right to stop payment of a cashier's check). See generally David J. Benson, *Stop Payment of Cashier's Checks and Bank Drafts Under the Uniform Commercial Code*, 2 OHIO N.U. L. REV. 445 (1975) (examining whether payment can be stopped on cashier's checks and bank drafts under the UCC); Brian J. Davis, *The Future of Cashier's Checks under Revised Article 3 of the Uniform Commercial Code*, 27 WAKE FOREST L. REV. 613 (1992) (analyzing the sources of uncertainty regarding cashier's checks); Francis H. Fox, *Stopping Payment on a Cashier's Check*, 19 B.C. L. REV. 683 (1978) (examining courts' treatment of rights and obligations arising from the issuance of cashier's checks); Lary Lawrence, *Making Cashier's Checks and Other Bank Checks Cost-Effective: A Plea for Revision of Articles 3 and 4 of the Uniform Commercial Code*, 64 MINN. L. REV. 275 (1980) (highlighting the problems associated with the failure of Articles 3 and 4 to establish separate rules for the various types of commercial paper and suggesting that the UCC be amended to allow the cashier's check to better serve the role of a cash substitute); John M. Norwood, *Cashier's Checks and the Bank's Right to Deny Payment*, 108 BANKING L.J. 476 (1991) (surveying the approaches of various courts to the issue of whether payment of a cashier's check may be denied by a bank); George Wallach, *Negotiable Instruments: The Bank Customer's Ability to Prevent Payment on Various Forms of Checks*, 11 IND. L. REV. 579 (1978) (discussing the obstacles to stopping payment of a bank instrument even when the bank is cooperating); Note, *Blocking Payment on a Certified, Cashier's, or Bank Check*, 73 MICH. L. REV. 424 (1974) (suggesting amendments to the UCC to clarify the rights and interests of the bank, remitter, and payee of a business check) [hereinafter Note, *Blocking Payment*]; Note, *Personal Money Orders and Teller's Checks: Mavericks Under the UCC*, 67 COLUM. L. REV. 524 (1967) (examining the issues surrounding stopping payment of personal money orders and teller's checks).

253. U.C.C. § 3-201(a) (1990) (emphasis added).

254. *Id.* § 3-203(a).

instrument constituted a transfer giving rise to transfer warranties by the issuer, no other substantive change has been made under Revised Article 3 by the new definitions. Issue was distinguishable under Former Article 3 from negotiation by definition, as well.²⁵⁵ "Issue" means the first delivery of an instrument to a holder or remitter,²⁵⁶ and "negotiation" is the transfer of an instrument in such form that the transferee becomes a holder.²⁵⁷ Even in delivering a blank instrument to the remitter under Former Article 3, no negotiation occurred because the remitter did not become a holder.²⁵⁸ Contrary to Revised Article 3, under Former Article 3, a blank signed instrument was not deemed to be bearer paper; it was only an incomplete instrument.²⁵⁹ The remitter did not become a holder, because a negotiation did not occur under the Former Article.²⁶⁰ Delivering an incomplete instrument to a purchaser under Revised Article 3 is an issuance but the purchaser is a holder because an incomplete instrument is bearer paper under the Revised Article,²⁶¹ and one in possession of bearer paper is a holder.²⁶²

The concern is the availability of relief to the issuer who wishes to retake possession of the instrument from a remitter who may have engaged in fraud or failed to give consideration for the instrument. Revised Section 3-202 permits any person to rescind the *negotiation* of an instrument to the extent permitted by other law, but does not address rescission of the *issuance* of an instrument.²⁶³

Consider the following scenario: Issuer is induced by fraud to issue a cashier's check to *B*, the remitter, payable to *C*'s order. Upon discovering the fraud, may Issuer reclaim the instrument? Under Revised Section 3-202, Issuer may reacquire the instrument from *C*, the party to whom the instrument was drawn payable, after its delivery to *C* by *B*.²⁶⁴ Section 3-202 permits

255. U.C.C. § 3-102(1)(a) (1989).

256. *See id.*

257. *Id.* § 3-202.

258. *See id.* § 3-202.

259. *See id.* § 3-115 (stating that a signed, incomplete instrument can not be enforced until completed); *id.* § 3-111 cmt. 2 (explaining that a blank, signed instrument must be treated as an incomplete order instrument falling under Section 3-115).

260. *See id.* § 3-202 cmt. 1.

261. *See* U.C.C. § 3-115 (1990).

262. *See* U.C.C. § 1-201(20) (1989).

263. *See* U.C.C. § 3-202(b) (1990).

264. *See id.* § 3-202 cmt. 2 (explaining that a holder in due course of an instrument, even an instrument negotiated to the holder by a thief, is protected

Issuer to employ several remedies, such as replevying the instrument or enjoining the further negotiation of the instrument by *C*, if *C* is not a holder in due course.²⁶⁵ Issuer would assert the right to rescind the negotiation by *B* to *C*.²⁶⁶ However, assume Issuer discovers the fraud before *B* negotiates the instrument to *C*. No provision of Revised Article 3 authorizes rescission of the issuance of the instrument. What recourse is available to Issuer?

Revised Section 3-306 subjects any person "taking an instrument," other than a holder in due course, to claims of a property or possessory right in the instrument or its proceeds.²⁶⁷ Although the issuance of the instrument is neither a negotiation nor a transfer of the instrument, it is by definition the first *delivery* of the instrument resulting in the remitter's "taking" of the instrument.²⁶⁸ Used repeatedly throughout Revised Article 3,²⁶⁹ neither "take"²⁷⁰ nor any of its derivatives is defined. Only in the context of conversion is light shed upon the meaning of the term. In distinguishing when payees have a right to assert an action in conversion against a proper defendant, namely the depositary or drawee banks, comment 1 to Revised Section 3-420 limits the right to those who have received delivery.²⁷¹ Only upon delivery to a payee is the payee deemed to have "taken" the instrument for the obligation.²⁷² "The payee receives delivery when the check comes into the payee's possession."²⁷³ Thus, the remitter "takes" the instrument upon the "voluntary transfer of possession"²⁷⁴ of the instrument when it comes into remitter's actual or constructive possession.²⁷⁵ Having taken the

against the claim of a rightful owner).

265. See *id.* § 3-202, cmt. 2.

266. See *id.* § 3-202(b).

267. See *id.* § 3-306.

268. See *id.* § 3-105(a).

269. See, e.g., *id.* §§ 3-103(a)(7), 3-307(b)(2), 3-403(a), 3-404(b)(2), 3-503(c), 3-418(c), 3-419(c).

270. In describing a holder in due course, Section 3-305 of former Article 3 substituted the term "takes" for the term "holds" which appeared in Section 57 of the Negotiable Instrument Law. See U.C.C. § 3-305 cmt. 1 (1989).

271. See U.C.C. § 3-420 cmt. 1 (1990).

272. See *id.* §§ 3-420(a), 3-310(b); see also *Peoria Sav. & Loan Ass'n v. Jefferson Trust & Sav. Bank of Peoria*, 410 N.E.2d 845, 848 (Ill. 1980) (reasoning that the plain meaning of the word "take" is to "get into one's possession," so a check delivered to the payee's desk was deemed to be "taken" for the purposes of Section 3-303(b)).

273. U.C.C. § 3-420 cmt. 1 (1990).

274. U.C.C. § 1-201(14) (1999).

275. See U.C.C. § 3-420(a)(ii) (1990) (stating that a payee can receive delivery either directly or through delivery to an agent or co-payee).

instrument, the remitter is subject to any claims that the issuer might assert.²⁷⁶

Historically, the law has recognized three kinds of rights in an instrument: claims or equities of ownership, legal title of legal ownership, and equities of defense.²⁷⁷ Claims, rights of restitution arising when possession of an instrument is voluntarily and intentionally transferred to another, were distinguished from equities of defense, a right to resist payment when liability on an instrument was established.²⁷⁸ Equities of defense fall into two categories: real defenses and personal defenses.²⁷⁹ Both claims and legal title were defined as property rights; with legal title resting in the one to whom the promise to pay ran.²⁸⁰ Legal title was distinct from a claim, a right to reclaim possession when legal title had been voluntarily transferred or surrendered to another.²⁸¹ These distinctions were blurred under Former Article 3.²⁸² The terms remain blurred under Revised Article 3, which, without including claims in recoupment,²⁸³ "expands" the concept of "claim" under Former Article 3.²⁸⁴ The drafters failed to disclose the particulars of this "expansion."

276. See *id.* § 3-306.

277. See WILLIAM EVERETT BRITTON, HANDBOOK OF THE LAW OF BILLS AND NOTES §§ 155-156, at 453 (2d ed. 1961); see also Brian A. Blum, *The Use of the Jus Tertii Defenses By an Obligor On a Negotiable Instrument*, COM. L.J., Jan. 1979, at 131 (explaining the types of third party claims and defenses); Zechariah Chafee, Jr., *Rights in Overdue Paper*, 31 HARV. L. REV. 1104, 1111 (1918) (defining equities of ownership and equities of defense); Grant Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1066 (1954) (discussing "real defenses"); Note, *Blocking Payment*, *supra* note 252, at 428 n.29 (reviewing the three classic definitions of legal title, equitable title, and contract defenses); Comment, *Adverse Claims and the Consumer: Is Stop Payment Protection Available?*, 67 NW. U.L. REV. 915, 921 (1973) (distinguishing "claims" from "defenses" as used in the UCC).

278. See BRITTON, *supra* note 277, § 156 at 456.

279. See *id.* § 155 at 453.

280. See Chafee, *supra* note 277, at 1112.

281. Refer to notes 278 and 280 *supra*.

282. Although Revised Article 3 continues the distinction between claims and defenses, some have argued that the distinction between the two under former Article 3 was unjustified and others have argued that the distinction was unintended. See, e.g., Blum, *supra* note 277, at 134 (asserting that the distinction between claims and defenses is not intended to have significance); Note, *Blocking Payment*, *supra* note 252, at 433 (declaring that there is no sound reason for the distinction between claims and defenses).

283. See U.C.C. § 3-306 cmt. (1990) (explaining that claims to an instrument under Section 3-306 are different from the claims in recoupment referred to in Section 3-305(a)(3)); see also *id.* § 3-305(a)(3) cmt. 3 (explaining the claims in recoupment).

284. See *id.* § 3-306 cmt. (listing types of claims allowed by Section 3-306 that were not included in the former Section 3-305).

An issuer might seek damages for breach of contract if the consideration given by the remitter has failed; for example, when a check negotiated to the issuer for a cashier's check is subsequently returned for insufficient funds.²⁸⁵ Alternatively, an issuer might bring an action in tort for fraud or seek quasi-contractual relief.²⁸⁶ However, reclaiming the instrument to prevent it from falling into the hands of a holder in due course is the most beneficial course of action, given the likelihood that the remitter might be insolvent or judgment proof.

Furthermore, Section 3-411(b) imposes expenses and consequential damages on an "obligated bank" that wrongfully refuses to pay a cashier's or teller's check that it issued.²⁸⁷ The obligated bank is not subject to these damages, however, if the refusal results from the bank's: (1) suspension of payments, (2) the assertion of a claim or defense that the bank reasonably believes is available against the person entitled to enforce the instrument, or (3) if payment is prohibited by law.²⁸⁸ The second exception to the imposition of damages, when "the obligated bank asserts a claim or defense of the bank that it has reasonable ground to believe is available *against the person entitled to enforce the instrument*,"²⁸⁹ is susceptible to two reasonable constructions. One construction is that the obligated bank may refuse to pay if the bank has its own claim or defense to the instrument. This construction is supported by the comments.²⁹⁰ If the obligated bank has its own defense, regardless of its source, it may refuse payment without the potential exposure for consequential damages.²⁹¹ An alternative construction is that the obligated bank must have its own claim or defense, and the claim or defense must be against the person seeking payment. In the hypothetical presented, if Issuer is an obligated bank and has a claim or defense against *B*, the remitter, the claim or defense is not one against *C*, the person to whom *B* negotiated the instrument.²⁹² Under the second construction, the bank must pay

285. See BRITTON, *supra* note 277, § 155 at 454.

286. See *id.* (suggesting this course of action against a wrongdoer when an instrument is negotiated to a holder in due course).

287. See U.C.C. § 3-411(b) (1990).

288. See *id.*

289. *Id.* (emphasis added).

290. See *id.* § 3-411 cmt. 3 (proclaiming that the likely situation where a bank could assert a defense is where there is reasonable doubt about the identity of the person demanding payment).

291. See *id.*; see also TPO, Inc. v. FDIC, 487 F.2d 131 (3d Cir. 1973) (suggesting that an obligated bank issuing its cashier's checks for its obligation may raise personal defenses against non-holders in due course).

292. See *id.* § 3-411(b) (stating that consequential damages are not recoverable if

or face consequential damages even if the holder is not a holder in due course. This construction expands the scope of Section 3-305, which limits the assertion of claims and defense beyond holders in due course to non-holders in due course in this limited context.²⁹³ At least one other section of Revised Article 3 supports this construction. Section 3-305(b) prohibits the assertion of claims in recoupment against a holder in due course unless the claim in recoupment arose from the conduct or obligations of the holder in due course, that is, those that are personal as between the holder in due course and the obligor.²⁹⁴ This construction for Section 3-411 would be consistent with the public expectation that cashier's checks, teller's checks, and certified checks function as a cash equivalent as recognized by Section 3-411.²⁹⁵ Issuer's ability to reacquire the instrument is a significant concern and becomes an even greater one under the second construction.

Currently, Revised Article 3 does not authorize rescission of issuance;²⁹⁶ however, Section 1-103 does permit supplementation of Revised Article 3, and viable options are available to the issuer for asserting its claim or equities of ownership such as replevying the instrument or enjoining transfer, as well as rescission of the implied or express contract between an issuer and a remitter on the basis of fraud.²⁹⁷ Comment 2 to Section 3-202 suggests that the drafters only intended to limit the right of reclamation of an instrument against those who are subsequent holders in due course.²⁹⁸ Without the right to reclaim the instrument, the issuer in the hypothetical context must hope that it has an opportunity to assert its claim (rescission because of fraud) or its defense (failure of consideration) against *B* if *B* should seek a refund²⁹⁹ or to enforce the instrument,³⁰⁰ an unlikely occurrence. Neither the claim nor the defense is effective against a subsequent party who

an obligated bank refuses payment based on a reasonable claim against the person entitled to enforce the instrument).

293. Refer to text accompanying note 264 *supra* (explaining the relationships and rights of the hypothetical parties).

294. See U.C.C. §§ 3-305(b) cmt. 3, 3-411(b) cmt. 3 (1990).

295. See *id.* § 3-411 cmt. 1.

296. Refer to notes 263-66 *supra* and accompanying text.

297. Refer to notes 267-86 *supra* and accompanying text.

298. See U.C.C. § 3-202 cmt. 2 (1990) (recounting the rule that a holder in due course may take an instrument even from a thief and be protected against a claim of a rightful owner).

299. See Maggs, *supra* note 252, at 639 (noting that many banks allow a remitter to return an instrument if he or she decides not to negotiate it to the payee).

300. See *id.* at 646-50 (discussing the rights of a remitter to enforce the instrument).

is a holder in due course.³⁰¹ With any delay in reacquiring the instrument, Issuer runs the risk that the instrument may fall into the hands of a holder in due course. Further development of the rights and obligations between an issuer and a remitter, including an express right to rescind the issuance of an instrument, should be included on the list of revisions.

IV. CONCLUSION

In the process of revising Article 3, the drafting committee hastily restructured the rights between the person entitled to enforce an instrument and the accommodation party. The resulting principles not only deprive the accommodation party of traditional rights but also modern equities recognized by the *Restatement* and Former Article 3. This Article demonstrates the likely confusion confronting the creditor/holder who seeks to take advantage of rights that Revised Article 3 presumes to provide, and the courts that seek to apply these principles. Although the rules of Revised Article 3 are perceived to elevate the creditor to the position of the "favorite of the law," they may in fact prove to be a trap resulting in loss. The unwary creditor may inadvertently lose presumed rights because of the supplementation of Revised Article 3 by the general law of suretyship, especially in the context of an indorser who is a guarantor of payment under Section 3-605 in transactions involving multiple sureties, or when the creditor requires a post-issuance accommodation.

Finally, with increased reliance by courts on the PEB Commentary and the growing promulgation of the Commentary, what parameters, if any, should be placed on the use of the Commentary by the courts under applicable principles of statutory construction? Should the doctrine of Separation of Powers, which provides insurance against courts taking on the "quasi-legislative" powers on the federal level, be likewise applicable to state courts in their role vis-à-vis state legislatures? If so, this doctrine should carry even greater weight when "quasi-legislative" power is exercised by an independent sponsor of statutory law. Despite the long hard battle to achieve codification of Revised 3, the plea of "[Revise] it again," will only increase as time goes by.

301. See U.C.C. § 3-305(b) (1990) (stating that the right of a holder in due course to enforce the instrument is not limited to a defense allowed under Article 3 or a claim in recoupment).