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Timothy R. Zinnecker*

I. INTRODUCTION

The trade volume for promissory notes is significant.¹ As trade terms are negotiated, the seller may discover that the original note has been lost, destroyed, or stolen. The absence of the note itself may limit, but not destroy, the marketability of the indebtedness that the note evidenced. By agreeing to indemnify a potential buyer against competing claims to the missing note, the seller may find a party willing to purchase the debt. But will lack of possession prevent the purchaser from enforcing the instrument?

The missing note may be a “negotiable instrument” governed by Article 3 of the Uniform Commercial Code (“U.C.C.” or “Code”).² A party that may enforce an instrument is known, appropriately, as a “person entitled to enforce,” a term carefully defined in section 3-301. The term acknowledges the possibility that instruments may be lost, destroyed, or stolen by extending enforcement rights to “a person not in possession of the instrument who is entitled to enforce the instrument” under section 3-309.³ Section 3-309, entitled “Enforcement of Lost, Destroyed, or Stolen Instrument,” permits a party to enforce a missing instrument if “the person *was in possession of the instrument* and entitled

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1. Many promissory notes that are traded are secured by real estate mortgages. MBS Clearing Corporation, a registered clearing agency with the Securities and Exchange Commission that provides automated post-trade comparison, netting, risk management, and pool notification services to the mortgage-backed securities market, processed a record volume of \$2.691 trillion in mortgage-backed securities in January 2001. *Press Release: MBS Clearing Corporation Processes Record Volume in January*, at <http://www.mbscc.com/press/index.html> (Feb. 12, 2001).

2. See U.C.C. § 3-102(a) (2000) (“This Article applies to negotiable instruments.”); *id.* § 3-104 (describing a “negotiable instrument”). Unless otherwise indicated, all citations are to Article 3 as revised in 1990. Revised Article 3 has been enacted in every state except New York and South Carolina. State U.C.C. Variations, U.C.C. Rep. Serv. (CBC) at xix-xx (2000).

3. U.C.C. § 3-301(iii).

to enforce it when loss of possession occurred.”⁴ This language prohibits enforcement of a lost, stolen, or destroyed instrument by a party that never possessed the instrument.

And that was the conclusion reached by the court in *Dennis Joslin Co. v. Robinson Broadcasting Corp.*⁵ But subsequent courts have not felt as constrained by the “prior possession” requirement of section 3-309. Some courts have found authority to extend enforcement rights to non-possessor parties in section 3-203,⁶ which states that transfer of an instrument “vests in the transferee any right of the transferor to enforce the instrument”⁷ Other courts have reached the same result but instead of relying on section 3-203 have applied general assignment principles incorporated through section 1-103,⁸ which states: “Unless displaced by the particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions.”⁹

Part II of this article serves as a primer on a “person entitled to enforce.” Part III examines the case law, concluding that each of the different analytical approaches is flawed and offering an alternative theory that is both statute-based and policy-oriented. Part IV reviews a proposed amendment to section 3-309 that will extend enforcement rights to a non-possessor that acquires ownership of the instrument, directly or indirectly, from a party with enforcement rights. The article concludes that the amendment will have a ripple effect throughout Article 3, necessitating additional revisions to possession-sensitive provisions.

4. *Id.* § 3-309(a)(i) (emphasis added). The non-possessor also must prove that loss of possession did not result from a transfer or lawful seizure and that the instrument cannot be possessed because it has been destroyed, its whereabouts are unknown, or because it is wrongfully held by an unknown person, a person that cannot be found, or a person not amenable to service. *Id.* § 3-309(a)(ii), (iii).

5. See 977 F. Supp. 491, 495 (D.D.C. 1997) (“Since plaintiff did not have possession of the note at the time it was lost it appears that [section 3-309], if applicable, precludes recovery.”).

6. See *infra* Part III.A.2 (discussing NAB Asset Venture II, L.P. v. Lenertz, Inc., 36 U.C.C. Rep. Serv. 2d (West) 474, 479 (Minn. Ct. App. 1998) and Bobby D. Assocs. v. DiMarcantonio, 751 A.2d 673, 676 (Pa. Super. Ct. 2000)).

7. U.C.C. § 3-203(b).

8. See *infra* Part III.A.3 (discussing Beal Bank, S.S.B. v. Caddo Parish-Villas S., Ltd., 218 B.R. 851, 855 (N.D. Tex. 1998), *aff’d*, 250 F.3d 300 (5th Cir. 2001) and YYY Corp. v. Gazda, 761 A.2d 395, 401 (N.H. 2000)). Cf. Southeast Invs., Inc. v. Clade, 40 U.C.C. Rep. Serv. 2d (West) 255, 258–59 (N.D. Tex. 1999) (reaching the same conclusion as, and citing, *Beal Bank* but never mentioning section 1-103), *aff’d*, 212 F.3d 595 (5th Cir. 2000).

9. U.C.C. § 1-103.

II. WHO IS A "PETE"?

An Article 3 negotiable instrument may be enforced only by a "person entitled to enforce" (often referred to as a "PETE"¹⁰). Section 3-301 defines a "person entitled to enforce" as "(i) the holder of the instrument, (ii) a nonholder 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)."¹¹ Analysis of each of the three subsections follows.

A. Holder¹²

Although described as "one of the most important terms of art used in Article Three,"¹³ "holder" is not defined anywhere therein. Instead, the definition is located in the "general definitions" section of Article 1.¹⁴ Section 1-201(20) states that a "holder" of a negotiable instrument is "the person in possession if the instrument is payable to bearer or, in the case of an instrument payable to an identified person, the identified person is in possession."¹⁵

A party must possess the instrument to be a holder.¹⁶ The U.C.C. does not define "possession," but, as noted by one scholar, "in context

10. See Steven L. Harris & Charles W. Mooney, Jr., *How Successful was the Revision of UCC Article 9?: Reflections of the Reporters*, 74 CHI.-KENT L. REV. 1357, 1381 (1999) (using acronym); Douglas J. Landy, *Failure of Consideration Is Not a Defense to a Bank's Refusal to Pay a Cashier's Check: Revised UCC § 3-411(c)*, 115 BANKING L.J. 92, 115 (1998) (same); Neil Littlefield & Kathleen Patchel, *Payments—Articles 3, 4 and 4A and Related Areas of Federal Law*, 50 BUS. LAW. 1493, 1497 (1995) (same).

11. U.C.C. § 3-301.

12. Much of my analysis of "holder" is drawn from Timothy R. Zinnecker, *A Literalist Proposes Four Modest Revisions to U.C.C. Article 3*, 32 U. RICH. L. REV. 63, 65–68 (1998).

13. James J. White, *Some Petty Complaints About Article Three*, 65 MICH. L. REV. 1315, 1315 (1967). See also Lary Lawrence, *Misconceptions About Article 3 of the Uniform Commercial Code: A Suggested Methodology and Proposed Revisions*, 62 N.C. L. REV. 115, 126 (1983) ("The term 'holder' is one of the most important and basic terms in Article 3.").

14. Unless the context otherwise requires, or another U.C.C. article contains an additional definition, terms used throughout the U.C.C. have the meaning ascribed to them in section 1-201. See U.C.C. § 1-201 (preamble).

15. *Id.* § 1-201(20). The definition is incorporated into Article 3 through section 3-103(d). For a suggested amendment to the definition of "holder," see Zinnecker, *supra* note 12, at 65–73.

16. U.C.C. § 1-201(20). See also *In re Kelton Motors, Inc.*, 97 F.3d 22, 26 (2d Cir. 1996) ("Thus, because there is no dispute here that the checks were drawn to Kelton Motors, it was a holder—and therefore entitled to enforce payment of the checks—only if Kelton Motors was ever in possession of the checks."); *Hall-Mark Elecs. Corp. v. Sims (In re Lee)*, 179 B.R. 149, 161 n.12 (B.A.P. 9th Cir. 1995) ("[O]ne cannot be a holder without possession."), *aff'd*, 108 F.3d 239 (9th Cir. 1997); *Miller-Rogaska, Inc. v. Bank One, Texas, N.A.*, 931 S.W.2d 655, 660 (Tex. App. 1996).

it is quite clear that it is intended to mean physical custody by the holder, or her agent."¹⁷

Possession alone is sufficient to create a holder if the instrument is "payable to bearer." Under section 3-109, an instrument is payable to bearer if it:

- (1) states that it is payable to bearer or to the order of bearer or otherwise indicates that the person in possession of the promise or order is entitled to payment; (2) does not state a payee; or (3) states that it is payable to or to the order of cash or otherwise indicates that it is not payable to an identified person.¹⁸

Examples of payee identification that make an instrument payable to bearer include the following:

- "pay to bearer" (or "pay to the order of bearer")¹⁹
 "pay to _____" (or "pay to the order of _____")²⁰
 "pay to Cash" (or "pay to the order of Cash")²¹
 "pay to the order of Sue Smith or bearer"²²

("For the reasons that follow, we conclude that without possession, actual or constructive, Miller cannot be a holder . . ."); *Weaver Landfill, Inc. v. Eastman Envtl. Transp. Servs.*, 37 U.C.C. Rep. Serv. 2d (West) 342, 343 (Va. Cir. Ct. 1998) ("As the intended holder was never in possession of the original promissory note, Plaintiff does not meet the statutory definition of a holder . . .").

17. Jeanne L. Schroeder, *Death and Transfiguration: The Myth that the U.C.C. Killed "Property,"* 69 TEMP. L. REV. 1281, 1327 n.171 (1996). See also 2 JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE: PRACTITIONER'S EDITION*, § 17-3, at 152 (4th ed. 1995) ("The ambiguity in the word 'possession' has caused little trouble. With rare exceptions, those claiming to be holders seem to have had physical possession of the instrument in question.") (footnote omitted).

18. U.C.C. § 3-109(a).

19. *Id.* § 3-109(a)(1); 6 WILLIAM D. HAWKLAND & LARY LAWRENCE, *UNIFORM COMMERCIAL CODE SERIES* § 3-109:2, at 98 (1999).

20. U.C.C. § 3-109(a)(2); see *id.* § 3-109(a)(2) cmt. 2 ("An instrument is also payable to bearer if it does not state a payee."); 6 HAWKLAND & LAWRENCE, *supra* note 19, § 3-109:2 at 99 ("An instrument which does not name a payee . . . is payable to bearer."); see also U.C.C. § 3-115 cmt. 2 (stating that a check with a blank payee line is an "incomplete instrument" under section 3-115(a) but nevertheless a negotiable instrument governed by Article 3). Under Former Article 3, an incomplete payee line made the instrument an incomplete order instrument rather than bearer paper. See Former U.C.C. § 3-111 cmt. 2 (stating that "pay to the order of ____" does not make the instrument payable to bearer). See also *Parker v. Pledger*, 601 S.W.2d 897, 900-01 (Ark. Ct. App. 1980) (holding mortgage instrument that failed to name payee was not payable to bearer); *Davis v. Davis*, 838 S.W.2d 415, 416 (Ky. Ct. App. 1992) (concluding note promising payment "to the order of: ____" was not payable to bearer).

21. U.C.C. § 3-109(a)(3); see *Bank of Glen Burnie v. Loyola Fed. Sav. Bank*, 648 A.2d 453, 459 (Md. 1994) (concluding checks made payable to "Cash" were bearer paper).

22. See U.C.C. § 3-109 cmt. 2 ("An instrument that purports to be payable both to order and bearer states contradictory terms. A transferee of the instrument should be able to rely on the bearer term and acquire rights as a holder without obtaining the indorsement of the identified payee.").

Any party—including not only an intended recipient but also a finder or a thief²³—who possesses an instrument that identifies the payee in any of the foregoing ways is a holder.

An instrument may identify a particular party as the payee by language such as “pay to Sue Smith or order” or “pay to the order of Sue Smith.” An instrument so drafted is not “payable to bearer,” but instead is “payable to order” and “payable to the identified person.”²⁴ Whereas any party in possession of an instrument “payable to bearer” is a holder,²⁵ only one party in possession can be the holder of an instrument “payable to order”: the identified party.²⁶ Any other possessor is not a holder.²⁷

B. Nonholders in Possession

Article 3 also bestows enforcement rights on parties other than holders. Section 3-301 conveys enforcement rights to “a nonholder in possession of the instrument who has the rights of a holder.”²⁸ A party that possesses an instrument is either a holder or a nonholder. The possessor is a holder if the instrument is either (i) payable to bearer or (ii) payable to an identified party, and the identified party is the possessor.²⁹ If the instrument is payable to an identified party other than the possessor, then the possessor is a “nonholder in possession.”

23. See *id.* § 3-203 cmt. 1 (“A thief who steals a check payable to bearer becomes the holder of the check and a person entitled to enforce it”); BARKLEY CLARK & BARBARA CLARK, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS* ¶ 12.03[1], at 12-7 (2001) (indicating that a crook who possesses bearer paper is a holder and a PETE).

24. See U.C.C. § 3-109(b) (describing how an instrument becomes payable to order).

25. See *id.* § 1-201(20) (defining “holder”).

26. *Id.*; see also *SMS Fin. v. ABCO Homes, Inc.*, 167 F.3d 235, 238 (5th Cir. 1999) (“When an instrument is payable to an identifiable person, the ‘holder’ is the person in possession if he is that identified person.”); *Thaler v. Lee Servicing Corp. (In re Joe Sipala & Son Nursery Corp.)*, 214 B.R. 281, 285 (Bankr. E.D.N.Y. 1997) (concluding party was holder because it “had possession of the checks” and “was the stated payee of said checks”).

27. See *Perrino v. Salem, Inc.*, 243 B.R. 550 (Bankr. D. Me. 1999) (“MPI was a nonholder of the cashier’s check because, although MPI was in possession of the instrument, the instrument was payable specifically to Salem.”); *Econo-Travel Motor Hotel Corp. v. Taylor*, 271 S.E.2d 54, 57 (N.C. 1980) (holding plaintiff’s possession of note payable to, and undorsed by, Econo-Travel Corporation, a separate and distinct corporate entity, did not cloak plaintiff with holder status).

U.C.C. Article 4 creates an exception to this rule. A customer may deposit a check payable to its order without indorsing the check. The depository bank is deemed a holder of the undorsed check even though the check remains “payable to order” and the depository bank is not the identified party. See U.C.C. § 4-205(1) (discussing the role of a depository bank in relation to an undorsed check). See also *id.* § 4-105(2) (defining “depository bank”).

28. *Id.* § 3-301(ii).

29. See *supra* Part II.A.

Two examples illustrate the foregoing. First, Father issues and delivers to Daughter a check payable to the order of Daughter. Daughter places the check in her purse but does not indorse it. Thief steals Daughter's purse. Thief possesses the check but is not a holder because the unindorsed check remains payable to Daughter, not Thief.³⁰ Instead, Thief is a "nonholder in possession." Second, Buyer issues and delivers to Seller a promissory note payable to the order of Seller. Seller sells and delivers the note to Finance Company, but Seller forgets to indorse the note. Finance Company possesses the note but is not a holder because the unindorsed note remains payable to Seller, not Finance Company.³¹ Instead, Finance Company is a "nonholder in possession."

As nonholders in possession, Thief and Finance Company enjoy enforcement rights only if they "ha[ve] rights of a holder."³² When does a nonholder in possession have rights of a holder? The Official Comments indicate that Article 3 conveys rights of a holder to a nonholder in possession through section 3-203.³³ Section 3-203 states: "Transfer of an instrument . . . vests in the transferee any right of the transferor to enforce the instrument . . ."³⁴ Therefore, Thief and Finance Company enjoy the enforcement rights of Daughter and Seller, respectively, if the movement of the check from Daughter to Thief and the movement of the note from Seller to Finance Company constitute a "transfer of an instrument."

According to section 3-203, "[a]n instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument."³⁵ Under this provision, an instrument is transferred only if (i) movement of the instrument from A to B is a "delivery" (defined in section 1-201

30. See U.C.C. § 1-201(20) (defining "holder").

31. *Id.*

32. See *id.* § 3-301(ii) (defining who is a PETE).

33. *Id.* § 3-301 cmt. The nonholder in possession may enjoy rights of a holder other than through section 3-203. See *id.* (referencing subrogation and successor-in-interest principles).

34. *Id.* § 3-203(b). This provision and its predecessor (Former U.C.C. § 3-201(1)) often are referred to as the "shelter rule" or "shelter provision." See, e.g., *Piper v. Goodwin*, 20 F.3d 216, 219-20 (6th Cir. 1994) (referring to former section 3-201(1) as the "shelter rule"); *Schwegmann Bank & Trust Co. v. Falkenberg*, 931 F.2d 1081, 1083 (5th Cir. 1991) (noting that former section 3-201(1) is "commonly known as the shelter rule"); Sarah Howard Jenkins, *Revised Article 3: "[Revise] it Again, Sam,"* 36 HOUS. L. REV. 883, 898-99 (1999) (referring to "the shelter doctrine of section 3-203(b)"); Curtis Nyquist, *A Spectrum Theory of Negotiability*, 78 MARQ. L. REV. 897, 904 (1995) (discussing "the shelter rule" of section 3-203).

35. U.C.C. § 3-203(a).

as a “voluntary transfer of possession”),³⁶ (ii) A is not the issuer of the instrument, and (iii) A’s purpose in delivering the instrument to B is to give B enforcement rights. Daughter did not voluntarily convey possession of the check to Thief, so the instrument was not transferred.³⁷ As a result, Thief neither inherits Daughter’s enforcement rights under section 3-203, nor qualifies as a PETE under section 3-301 as a nonholder in possession with rights of a holder.

But Seller did voluntarily transfer possession of the note to Finance Company, satisfying the first statutory requirement of section 3-203. Also, Seller was not the “issuer,” a term referring to “a maker or drawer of an instrument.”³⁸ As the instrument is a note, the issuer is a “maker,” a term defined as “a person who signs or is identified in a note as a person undertaking to pay.”³⁹ Buyer, rather than Seller, undertook to pay the note. Therefore, Buyer, and not Seller, is the issuer, and the second statutory requirement of section 3-203 is present. The third statutory requirement of section 3-203 also is met, as Seller conveyed the note to Finance Company for the purpose of permitting Finance Company to enforce the note against the issuer, Buyer.⁴⁰ All three elements are satisfied, so the movement of the note from Seller to Finance Company is a “transfer of an instrument” under section 3-203. As a result, Finance Company qualifies as a PETE under section 3-301 as a nonholder in possession with rights of a holder.⁴¹

36. *Id.* § 1-201(14). Article 3 incorporates the Article 1 definition of “delivery” through section 3-103(d).

37. See 6 HAWKLAND & LAWRENCE, *supra* note 19, § 3-203:2, at 194–95 (noting that because of the delivery requirement, “neither a thief, a person obtaining possession by mistake, nor a person possessing the instrument in trust for the transferor are transferees”).

38. U.C.C. § 3-105(c).

39. *Id.* § 3-103(a)(5).

40. Official Comment 1 to section 3-203 provides an example of a situation in which a party conveys an instrument to another party for a purpose other than enforcement: “For example, if a check is presented for payment by delivering the check to the drawee, no transfer of the check to the drawee occurs because there is no intent to give the drawee the right to enforce the check.”

41. For a similar case, see *McMullen Oil Co. v. Crysen Ref., Inc.* (*In re McMullen Oil Co.*), 251 B.R. 558, 568 (Bankr. C.D. Cal. 2000) (holding bank that received unindorsed checks was not a holder but was a nonholder in possession with enforcement rights of its transferor).

If Finance Company gave value for the unindorsed note, then Finance Company has a statutory right under section 3-203(c) to the Seller’s unqualified indorsement. Finance Company’s possession of the note indorsed by Seller makes Finance Company a holder under section 1-201(20) and a PETE under section 3-301(i). Finance Company prefers to be a PETE as a holder, rather than as a nonholder in possession with rights of a holder, for reasons discussed in section 3-203, Official Comment 2 (first paragraph).

C. *Non-possessors of Lost, Destroyed, or Stolen Instruments*

In the previous example involving Father, Daughter, and Thief, Thief possessed the stolen check but was not a PETE.⁴² Might Daughter be a PETE? Daughter cannot be a holder because she no longer possesses the stolen check.⁴³ For the same reason she fails to qualify as a nonholder with rights of a holder.⁴⁴ But even absent possession of the stolen check, Daughter will be a PETE under section 3-301 if she "is entitled to enforce the instrument pursuant to Section 3-309"⁴⁵

Section 3-309 states:

A person not in possession of an instrument is entitled to enforce the instrument if (i) the person was in possession of the instrument and entitled to enforce it when loss of possession occurred, (ii) the loss of possession was not the result of a transfer by the person or a lawful seizure, and (iii) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.⁴⁶

Daughter, a person lacking possession, satisfies the requirements of clause (i). Immediately prior to the theft she possessed the check.⁴⁷

42. See *supra* notes 30–37 and accompanying text.

43. See *supra* note 16 and accompanying text.

44. See U.C.C. § 3-301(ii) (requiring possession).

45. *Id.* § 3-301(iii). Section 3-301(iii) also references section 3-418(d), which applies when payment is made by mistake. For example, Buyer issues and delivers a check to Seller as payment for goods to be delivered in thirty days. Before Seller delivers the goods, Buyer stops payment on the check under section 4-403. A bank teller fails to discover the stop payment order and pays the check on Seller's presentment. The bank discovers its teller's error and attempts to recover the erroneous payment from Seller. See *id.* § 3-418(a) (permitting the bank, as drawee, to recover the amount of the mistaken payment from Seller, either as the party to whom payment was made [if the bank made payment directly to Seller] or the party for whose benefit payment was made [if the bank made payment indirectly to Seller, such as to Seller's bank]); *id.* § 3-418(c) (prohibiting recovery from Seller if Seller either took the instrument in good faith and for value [e.g., delivering the goods] or in good faith changed its position in reliance on the payment [e.g., customizing standard goods to conform to Buyer's special order]). If the bank's recovery is successful, then section 3-418(d) permits Seller to enforce the check against Buyer, even if Seller does not possess the check.

46. *Id.* § 3-309(a).

47. See *Dennis Joslin Co. v. Robinson Broad. Corp.*, 977 F. Supp. 491, 494–95 (D.D.C. 1997) (holding plaintiff who never possessed promissory note could not enforce note under section 3-309); *Weaver Landfill, Inc. v. Eastman Envtl. Transp. Servs.*, 37 U.C.C. Rep. Serv. 2d (West) 342, 342–43 (Va. Cir. Ct. 1998) (same). But see *Southeast Invs., Inc. v. Clade*, 40 U.C.C. Rep. Serv. 2d (West) 255, 256–58 (N.D. Tex. 1999) (concluding failure to possess note at any time did not preclude party from asserting enforcement rights under section 3-309), *aff'd*, 212 F.3d 595 (5th Cir. 2000); *Beal Bank, S.S.B. v. Caddo Parish-Villas S., Ltd.*, 218 B.R. 851, 854–55 (N.D. Tex. 1998) (same), *aff'd*, 250 F.3d 300 (5th Cir. 2001); *NAB Asset Venture II, L.P. v. Lenertz, Inc.*, 36 U.C.C. Rep. Serv. 2d (West) 474, 478–79 (Minn. Ct. App. 1998) (same); *YYY Corp. v. Gazda*, 761 A.2d 395, 400–01

And because the check was payable to the order of Daughter, her possession made her a holder⁴⁸ and a PETE⁴⁹ when loss of possession occurred. Clause (ii) is also met. The check was stolen, not lawfully seized, and the involuntary movement from Daughter to Thief prevents a “transfer.”⁵⁰ The third clause is also met if Daughter cannot obtain possession of the check for any of the three stated reasons, two of which Daughter may invoke: the whereabouts of the stolen check cannot be determined; and the check is in wrongful possession of Thief (a person who is unknown, who cannot be found, or who is not amenable to service of process). As all three clauses of section 3-309(a) are present, Daughter is a PETE even though she no longer possesses the stolen check.⁵¹

The issue that has confronted the courts is whether an assignee of Daughter’s interest in the instrument is a PETE. Because the assignee never possesses the instrument, can she claim PETE status under section 3-301(iii) via section 3-309(a)? Should the assignee attempt to look elsewhere—perhaps the shelter doctrine of section 3-203, or outside Article 3 via section 1-103? Is Daughter’s possession prior to the theft, but the assignee’s lack of any possession, a factor that justifies different treatment? Will extension of PETE status to the assignee increase the risks borne by the issuer of the missing instrument? Does Article 3 adequately address these risks? Part III addresses these concerns.

(N.H. 2000) (same); *Bobby D. Assocs. v. DiMarcantonio*, 751 A.2d 673, 675–76 (Pa. Super. Ct. 2000) (same).

48. See U.C.C. § 1-201(20) (defining “holder”).

49. See *id.* § 3-301(i) (conferring PETE status on holders).

50. A “transfer” requires “delivery,” and “delivery” requires voluntary movement. See *supra* notes 35–36 and accompanying text. See also *A.C.E. Inc. v. Inland Mortgage Co.*, 969 S.W.2d 176, 177–78 (Ark. 1998) (holding joint payee’s delivery of check to forger was a transfer and barring victim from asserting enforcement rights under section 3-309(a)).

51. Successful application of section 3-309 may permit more than one party to qualify as a PETE. For example, if Daughter had indorsed the check with a blank indorsement before Thief stole her purse, both Thief (through section 3-301(i) as a holder) and Daughter (through section 3-301(iii) and section 3-309) would enjoy rights of enforcement. This places Father at risk of being obligated to pay the check twice (especially if the party in possession qualifies as a holder in due course). Section 3-309(b) reduces Father’s risk of double payment by requiring Daughter to prove the terms of, and her right to enforce, the stolen instrument. Furthermore, a court may not enter judgment in favor of Daughter unless the court finds that Father “is adequately protected against loss that might occur by reason of a claim by another person [such as Thief] to enforce the instrument.” U.C.C. § 3-309(b). “Adequate protection” is a flexible concept and may be provided by any reasonable means (e.g., indemnification agreement, segregated cash account, etc.). *Id.* § 3-309(b) & cmt. See also *infra* notes 130–33 and accompanying text (discussing section 3-309(b)).

III. EXTENDING PETE STATUS TO A PARTY THAT NEVER POSSESSED THE INSTRUMENT

Maker executes a negotiable promissory note payable to the order of First Bank. Somehow, First Bank loses the note. Later, First Bank sells and assigns its interest in the lost note to Second Bank. May Second Bank, which never possessed the note, enforce the lost note either personally or, by asserting any enforcement rights previously held by First Bank, derivatively?

A handful of courts have confronted the issue under Revised Article 3, reaching contrary results. Those that have reached the same result often have traveled different analytical paths. An early decision—*Dennis Joslin Co. v. Robinson Broadcasting Corp.*—adhered to the language of section 3-309(a) and its requirement that the party seeking to enforce the lost instrument must have possessed the instrument prior to its loss.⁵² But subsequent cases have declined to follow *Dennis Joslin*, refusing to be constrained by the possession requirement of section 3-309(a). Instead, relying on either the shelter doctrine of section 3-203 or general principles of law under section 1-103, such courts have concluded that a non-possessor can assert the enforcement rights of its transferor if the transferor qualified as a PETE under section 3-309(a).⁵³

Part III.A reviews the three analytical paths traveled by courts in recent decisions and concludes, solely from a *statutory* perspective, that *Dennis Joslin* is the only decision that reaches the proper result: a party cannot enforce an instrument that it never possessed. Decisions that reach a contrary decision by relying on either section 3-203 or section 1-103 rest on flawed analysis. Part III.B, however, examines the issue from a *policy* perspective and concludes that an assignee should be permitted to assert the enforcement rights of its assignor. Part III.C offers an alternative statutory analysis for reaching this proper policy-oriented result.

52. 977 F. Supp. at 494.

53. See *NAB Asset Venture II, L.P. v. Lenertz, Inc.*, 36 U.C.C. Rep. Serv. 2d (West) 474, 479 (Minn. Ct. App. 1998) (relying on section 3-203); *Bobby D. Assocs. v. DiMarcantonio*, 751 A.2d 673, 676 (Pa. Super. Ct. 2000) (same). See *Beal Bank, S.S.B. v. Caddo Parish-Villas S., Ltd.*, 218 B.R. 851, 855 (N.D. Tex. 1998) (relying on section 1-103), *aff'd*, 250 F.3d 300 (5th Cir. 2001); *YYY Corp. v. Gazda*, 761 A.2d 395, 401 (N.H. 2000) (same).

A. "My Statute Can Beat Your Statute"

1. Enforcement Prohibited by Section 3-309

In *Dennis Joslin Co. v. Robinson Broadcasting Corp.*,⁵⁴ Robinson Broadcasting (Robinson) executed a \$600,000 promissory note in 1985 that was payable to the order of Madison National Bank (the Bank).⁵⁵ The Federal Deposit Insurance Corporation (FDIC), acting as receiver for the Bank, acquired the note in 1991 but later sold it to 4M Communications (4M).⁵⁶ In March 1997, 4M received an affidavit from the FDIC, in which the FDIC admitted that it had lost the original note.⁵⁷ Shortly thereafter 4M assigned its interest in the note to the Dennis Joslin Company (Joslin).⁵⁸

When Joslin sued Robinson for payment, Robinson filed a motion to dismiss the lawsuit, contending that section 3-309 prevented Joslin from enforcing the note.⁵⁹ In examining the U.C.C. defense, the court noted that former section 3-804 allowed the "owner of an instrument which is lost" to enforce the instrument "upon due proof of his ownership, the facts which prevent his production of the instrument and its terms."⁶⁰ Under this predecessor statute, Robinson could not assert the lost note defense if Joslin proved ownership, the terms of the note, and the reason for non-production.⁶¹ But the court observed that Revised Article 3 changed the lost note defense.⁶² Under section 3-309, a person may enforce a lost instrument only if "the person was in possession of the instrument and entitled to enforce it when loss of possession oc-

54. 977 F. Supp. 491 (D.D.C. 1997).

55. *Freeman v. FDIC*, 842 F. Supp. 2, 4 (D.D.C. 1993).

56. *Dennis Joslin*, 977 F. Supp. at 492.

57. *Id.*

58. *Id.*

59. *Id.* at 492-93. Before turning to the merits of the U.C.C. defense, the court first addressed Joslin's argument that 12 U.S.C. § 1821(j) precluded the court from reaching the merits of Robinson's defense. Subject to limited exceptions, 12 U.S.C. § 1821(j) prohibits a court from taking any action to "restrain or affect the exercise of powers or functions of the [Federal Deposit Insurance] Corporation as a conservator or a receiver." *Id.* at 493 (quoting 12 U.S.C. § 1821(j) (1989)). The court held that the federal statute was inapplicable for two reasons. First, the court was not persuaded that recognizing the defense against Joslin would, in any way, impair the FDIC's functions as conservator or receiver. *Id.* And second, while the federal statute prevents parties from initiating a lawsuit against the FDIC in its capacity as receiver or conservator, "it is not at all clear that the provision was intended to prevent defendants from raising affirmative defenses to suits brought by the FDIC or those purporting to stand in its shoes." *Id.* at 493-94.

60. *Id.* at 494 (quoting D.C. code § 28:3-804 (1973) (superseded 1995); U.C.C. § 3-804 (superseded 1991)).

61. *Id.*

62. *Id.* at 494-95.

curred.”⁶³ The court acknowledged that the FDIC, which lost the note, may have had enforcement rights at the time of loss.⁶⁴ Nevertheless,

[w]hile there does not appear to be a logical reason to distinguish between a person who was in possession at the time of the loss and one who later comes into possession of the rights to the note, the plain language of the provision mandates that the plaintiff suing on the note must meet two tests, not just one: it must have been *both* in possession of the note when it was lost and entitled to enforce the note when it was lost. Since [Joslin] did not have possession of the note at the time it was lost it appears that the new provision, if applicable, precludes recovery.⁶⁵

The court then granted Robinson’s motion to dismiss.⁶⁶

The facts in *Dennis Joslin* are straightforward. Section 3-309 is not ambiguous or confusing, and its relevance cannot be disputed. Applying the law to the facts leads to only one conclusion: absent prior possession, section 3-309 prohibits a party from enforcing an instrument that is lost, destroyed, or stolen. The decision rests on a sound statutory foundation.⁶⁷

63. U.C.C. § 3-309(a)(i) (2000).

64. *Dennis Joslin*, 977 F. Supp. at 495.

65. *Id.* (citation omitted).

66. *Id.* at 496.

67. Nevertheless, *Dennis Joslin* has not been well-received. See, e.g., *YYY Corp. v. Gazda*, 41 U.C.C. Rep. Serv. 2d (West) 222, 223 (N.H. 2000) (Editors’ Note: “This is another important decision rejecting the erroneous and much criticized interpretation and application of revised § 3-309 in [*Dennis Joslin*].”); ROBERT L. JORDAN ET AL., *NEGOTIABLE INSTRUMENTS, PAYMENTS AND CREDITS* 125 (5th ed. 2000) (“We disagree with the holding in [*Dennis Joslin*].”); Stephen C. Veltri et al., *Payments*, 56 Bus. Law. 1783, 1791 (2001) (referring to cases contrary to *Dennis Joslin* as “better reasoned”); Neil O. Littlefield, *Payments: Articles 3, 4, and 4A*, 54 BUS. LAW. 1865, 1870 (1999) (summarizing *Dennis Joslin* and suggesting that “courts ought to prevent a wooden application of [section 3-309]”). No reported decision has followed *Dennis Joslin*. Furthermore, Revised Article 9, which applies to the sale of promissory notes, expressly rejects *Dennis Joslin*:

A “sale” of an account, chattel paper, a promissory note, or a payment intangible includes a sale of a right in the receivable, such as a sale of a participation interest. The term also includes the sale of an enforcement right. For example, a “[p]erson entitled to enforce” a negotiable promissory note (Section 3-301) may sell its ownership rights in the instrument. See Section 3-203, Comment 1 (“Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3, which do not depend upon whether the instrument was transferred under Section 3-203.”). Also, the right under Section 3-309 to enforce a lost, destroyed, or stolen negotiable promissory note may be sold to a purchaser who could enforce that right by causing the seller to provide the proof required under that section. This Article rejects decisions reaching a contrary result, e.g., *Dennis Joslin Co. v. Robinson Broadcasting*, 977 F. Supp. 491 (D.D.C. 1997).

U.C.C. Rev. § 9-109 cmt. 5 (2000).

2. Enforcement Permitted by Section 3-203

Subsequent cases have declined to follow *Dennis Joslin*, concluding that the law of assignment permits a party with enforcement rights under section 3-309 (i.e., the person that lost the instrument) to convey those enforcement rights to its assignee (who, on its own, cannot invoke section 3-309 because it never possessed the lost instrument). Article 3 does not expressly state that a party with enforcement rights under section 3-309 may assign those rights to a non-possessor party. But Article 3 does include a broad assignment provision, section 3-203, which vests in a transferee the enforcement rights of a transferor.⁶⁸ Two decisions, *Bobby D. Associates v. DiMarcantonio*,⁶⁹ and *NAB Asset Venture II, L.P. v. Lenertz, Inc.*,⁷⁰ expressly relied on state versions of section 3-203(b) to reach decisions contrary to *Dennis Joslin*.

In *Bobby D. Associates*, three co-makers executed two promissory notes in favor of Guardian Credit Corporation (Guardian).⁷¹ Later, Guardian transferred the two notes to Oxford Finance Companies (Oxford).⁷² After the co-makers defaulted, Oxford sold both notes to Bobby D. Associates (BDA).⁷³ Because Oxford had lost one of the notes, it executed a lost note affidavit in favor of BDA.⁷⁴ When litigation ensued, the co-makers argued that section 3-309 prevented BDA from enforcing the lost note.⁷⁵ The trial court ruled in favor of BDA after concluding that section 3-309 “was not intended to prevent future assignment of the Note.”⁷⁶ The appellate court affirmed.⁷⁷ No one disputed that Oxford lost the note and therefore could have enforced it under section 3-309.⁷⁸ Nor did anyone dispute that Oxford had assigned all of its rights in the note to BDA.⁷⁹ And because section 3-

68. U.C.C. § 3-203(b). *Dennis Joslin* never mentions this statute specifically. One court criticized *Dennis Joslin* for failing to consider the assignability of enforcement rights. See *infra* note 102.

69. 751 A.2d 673 (Pa. Super. Ct. 2000).

70. 36 U.C.C. Rep. Serv. 2d (West) 474 (Minn. Ct. App. 1998).

71. 751 A.2d at 674.

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* at 676.

78. *Id.* at 674.

79. *Id.*

203(b) vests in the transferee "any right of the transferor to enforce the instrument," BDA could enforce the lost note.⁸⁰

In *NAB Asset Venture II*, Lenertz and its affiliate each executed a promissory note payable to Midwest Federal Savings and Loan (Midwest Federal).⁸¹ Later, the Resolution Trust Company (the RTC) was appointed as receiver of Midwest Federal and sold both notes to NAB Asset Venture II, L.P. (NAB).⁸² The RTC provided NAB with copies of the notes but never produced and delivered the originals.⁸³ When NAB sued to enforce the Lenertz note, the district court ruled that NAB was entitled to judgment because "[t]he transfer of rights [from the RTC to NAB] included the right to collect under the lost, destroyed or stolen instrument statute."⁸⁴ Lenertz appealed, arguing that section 3-309 barred NAB from enforcing a note that NAB never possessed.⁸⁵ The appellate court disagreed.⁸⁶ It was "undisputed" that the RTC was entitled under section 3-309 to enforce the note that had been lost while in its possession.⁸⁷ Relying on section 3-203(b), which vests in a transferee "any right of the transferor to enforce the instrument," the court then held that NAB, as the RTC's transferee, was entitled to assert the RTC's enforcement rights.⁸⁸

Careful examination of the language of section 3-203(b) reveals that the shelter doctrine does not support any conclusion to extend enforcement rights to assignees of lost, destroyed, or stolen instruments. Section 3-203(b) states: "Transfer of an instrument . . . vests in the transferee any right of the transferor to enforce the instrument . . ." A casual reading suggests that this provision permits a transferor to assign its enforcement rights under section 3-309 to a transferee, a result at odds with *Dennis Joslin* (but nevertheless rooted in statute). This result, however, overlooks the first four words of the statute: "Transfer of an instrument." Only if an instrument is transferred will enforcement

80. *Id.* The appellate court affirmed the judgment after noting that the trial court had required BDA to execute an indemnification agreement in favor of the co-makers, satisfying the adequate protection requirement of section 3-309(b). *Id.* at 676.

81. *NAB Asset Venture II, L.P. v. Lenertz, Inc.*, 36 U.C.C. Rep. Serv. 2d (West) 474, 476 (Minn. Ct. App. 1998).

82. *Id.*

83. *Id.* at 477.

84. *Id.* at 478.

85. *Id.*

86. *Id.*

87. *Id.* at 479.

88. *Id.* The court further added that the district court had not erred in failing to require NAB to provide any adequate protection under section 3-309(b) because it was "unlikely" that any party would bring an additional claim on the instrument against Lenertz. *Id.* at 479-80.

rights vest in the transferee. And an instrument cannot be transferred absent delivery,⁸⁹ which requires “a voluntary transfer of *possession*.”⁹⁰ Absent possession there can be no delivery; without delivery an instrument cannot be transferred. And unless the instrument is transferred, a transferee is not sheltered to the enforcement rights of its transferor. Article 3's assignment provision, section 3-203(b), does not permit a court to conclude that enforcement rights under section 3-309 may be conveyed to a party that never possessed the instrument.

3. Enforcement Permitted by Section 1-103

Cases contrary to *Dennis Joslin* also have rested their decisions to extend enforcement rights to non-possessor parties on general assignment principles incorporated through a statutory source outside Article 3: section 1-103. This provision states: “Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.”⁹¹ Section 1-103 does not specifically mention the law of

89. See U.C.C. § 3-203(a) (2000) (“An instrument is transferred *when it is delivered*”) (emphasis added).

90. See *id.* § 1-201(14) (defining “delivery”) (emphasis added); *id.* § 3-103(d) (incorporating Article 1 definitions of terms not otherwise defined in Article 3).

91. *Id.* § 1-103. Professors White and Summers have described section 1-103 as “probably the most important single provision in the Code” 1 JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE: PRACTITIONER'S EDITION*, § 2, at 6 (3d ed. 1988). Section 1-103 has been the subject of much scholarship. See, e.g., Sarah Howard Jenkins, *Preemption & Supplementation Under Revised 1-103: The Role of Common Law & Equity in the New U.C.C.*, 54 SMU L. REV. 495 (2001) (analyzing the proposed revision of section 1-103); Robyn L. Meadows, *Code Arrogance and Displacement of Common Law and Equity: A Defense of Section 1-103 of the Uniform Commercial Code*, 54 SMU L. REV. 535 (2001) (arguing that section 1-103 should not be revised to broaden the scope of the U.C.C.); Gregory E. Maggs, *Karl Llewellyn's Fading Imprint on the Jurisprudence of the Uniform Commercial Code*, 71 U. COLO. L. REV. 541, 572–78 (2000) (summarizing the historical transition of the U.C.C.'s nonexclusivity); Mark D. Rosen, *What Has Happened to the Common Law?—Recent American Codifications, and Their Impact on Judicial Practice and the Law's Subsequent Development*, 1994 WIS. L. REV. 1119, 1181–85 (discussing the courts' use of section 1-103 to supplement the U.C.C.); 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, 798–800 (1990) (discussing to what extent the courts displace the common law with the U.C.C.); David Frisch, *Buyer's Remedies and Warranty Disclaimers: The Case for Mistake and the Indeterminacy of U.C.C. Section 1-103*, 43 ARK. L. REV. 291, 333–43 (1990) (arguing that it is not possible to determine which common law has been displaced by the U.C.C.); Robert S. Summers, *General Equitable Principles Under Section 1-103 of the Uniform Commercial Code*, 72 NW. U. L. REV. 906 (1978) (discussing appropriate applications of section 1-103); Robert A. Hillman, *Construction of the Uniform Commercial Code: UCC Section 1-103 and “Code” Methodology*, 18 B.C. INDUS. & COM. L. REV. 655

assignment. The listing, however, "is merely illustrative; no listing could be exhaustive."⁹² Two cases that relied on section 1-103 to permit assignment of enforcement rights are *Beal Bank, S.S.B. v. Caddo Parish-Villas South, Ltd.*,⁹³ and *YYY Corp. v. Gazda*.⁹⁴

In *Beal Bank*, Caddo Parish-Villas South (Caddo Parish) executed a promissory note in 1971 payable to the order of Housing America Mortgage Company, which endorsed and delivered the note and underlying mortgage to Federal National Mortgage Association (FNMA) two years later.⁹⁵ FNMA then assigned the note and mortgage to the Secretary of Housing and Urban Development (HUD), which held the note and mortgage for twenty-one years before assigning the note and mortgage to Beal Bank (the Bank).⁹⁶ HUD failed to deliver the original note to the Bank because the note could not be located.⁹⁷ HUD did tell the Bank that it had not assigned, transferred, or sold the note or mortgage to any other party.⁹⁸ When Caddo Parish filed a bankruptcy petition in November 1996, the Bank filed a proof of claim based on its rights in

(1977) (proposing a system to address the ambiguities of the U.C.C.).

92. U.C.C. § 1-103 cmt. 3.

93. 218 B.R. 851 (N.D. Tex. 1998), *aff'd*, 250 F.3d 300 (5th Cir. 2001). A subsequent decision, *Southeast Investments, Inc. v. Clade*, 40 U.C.C. Rep. Serv. 2d (West) 255 (N.D. Tex. 1999), *aff'd*, 212 F.3d 595 (5th Cir. 2000), reached the same result as (and cited) *Beal Bank* but did not reference section 1-103. In *Southeast Investments*, Clade Enterprises and Leona Clade executed a promissory note payable to the order of the FDIC, which then sold and assigned the note to Southeast Investments. 40 U.C.C. Rep. Serv. 2d (West) at 255-56. The FDIC never delivered the original note, which it had lost. *Id.* at 256. Southeast Investments sued to recover the balance of the note, proving its undisputed terms by submitting a photocopy. *Id.* The co-makers moved for summary judgment, contending that the possession requirement of section 3-309 barred Southeast Investments from enforcing the lost note. *Id.* The court disagreed. It acknowledged that "[e]nforcement of a negotiable instrument under [section 3-309] requires possession by the claimant before the instrument is lost." *Id.* at 257. It further recognized that Southeast Investments "has never been in possession of the original Note, as it was lost by the FDIC prior to its assignment to [Southeast Investments]." *Id.* Nevertheless, the court held that Southeast Investments could enforce the lost note that it had never possessed. Citing Texas case law, as well as *Beal Bank*, the court wrote:

As the assignee of the Note, Plaintiff stands in the shoes of the FDIC and obtains all of the rights, title, and interest that the FDIC had at the time of the assignment. This includes rights of enforceability under [section 3-309]. Plaintiff has demonstrated that the FDIC satisfied the requirements of [section 3-309], thus Plaintiff is entitled to enforce the Note as the FDIC's assignee.

Id. at 257-58 (citations omitted). The court also observed that Southeast Investments had satisfied the requirements of section 3-309(b) by submitting a copy of the note and offering to indemnify the co-makers for any future claims on the note. *Id.* Nevertheless, the court held that Southeast Investments was not entitled to any money because the co-makers had fully satisfied their payment obligations under the terms of the note. *Id.* at 258-59.

94. 761 A.2d 395 (N.H. 2000).

95. 218 B.R. at 852.

96. *Id.*

97. *Id.*

98. *Id.*

the mortgage note.⁹⁹ Relying on section 3-309, the bankruptcy judge disallowed the Bank's claim because the Bank never possessed the note.¹⁰⁰ On appeal, the district judge acknowledged the unambiguous possession requirement of section 3-309 but noted "there is nothing in the language of Section 3-309(a) or the legislative history to indicate that a person entitled to enforce a negotiable instrument under Section 3-309 cannot assign these rights to another party."¹⁰¹ Observing that HUD was a person entitled under section 3-309 to enforce the note at the time of its loss, the court then considered whether HUD could assign those enforcement rights to the Bank.¹⁰² The court did not believe that section 3-309 explicitly addressed the assignability of HUD's enforcement rights, so it turned to section 1-103 and non-Code law.¹⁰³ Under Louisiana's general assignment laws, an assignee (e.g., the Bank) steps into the shoes of its assignor (e.g., HUD).¹⁰⁴ Therefore, the court held that the Bank could exercise HUD's enforcement rights.¹⁰⁵

99. *Id.*

100. *Id.* at 852-54.

101. *Id.* at 854.

102. *Id.* The court recognized *Dennis Joslin* as factually similar but did not feel obligated to follow the result because its sister court "did not . . . consider the issue that this Court views as primary in this appeal: whether a party who is entitled to enforce a lost instrument may assign its rights to enforce the instrument under Section 3-309(a)." *Id.* at 854-55. The criticism is unfair. See *Dennis Joslin Co. v. Robinson Broad. Corp.*, 977 F. Supp. 491, 495 (D.D.C. 1997) (acknowledging the possibility that "the FDIC could assign to plaintiff any enforcement rights that it possessed at the time the note was lost" but finding "difficulty with this interpretation" because section 3-309 "clearly states that the person suing on a lost note is entitled to enforce the note if that person 'was in possession of the instrument when loss of possession occurred'" (quoting U.C.C. § 3-309 (emphasis added))).

103. *Beal Bank*, 218 B.R. at 855.

104. *Id.* (citing LA. CIV. CODE ANN. arts. 2642-2654 (West 1995)).

105. *Id.* The court then turned to section 3-309(b), which requires any person enforcing an instrument under section 3-309(a) to "prove the terms of the instrument and the person's right to enforce the instrument." *Id.* (citing Louisiana's version of section 3-309(b)). The court noted that the Bank had proven the terms of the instrument by submitting a copy of the promissory note to the bankruptcy court, and it had proven its right to enforce the instrument through general assignment law. *Id.* Nevertheless, section 3-309(b) prevented the court from entering judgment in favor of the Bank absent any evidence that Caddo Parish was "adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument." *Id.* (quoting Louisiana's version of section 3-309(b)). The court then remanded the issue of adequate protection to the bankruptcy court for determination. *Id.* at 856.

Caddo Parish appealed the district court's order reversing and remanding the bankruptcy court's order. *Beal Bank, S.S.B. v. Caddo Parish-Villas S., Ltd. (In re Caddo Parish-Villas, S., Ltd.)*, 174 F.3d 624, 625 (5th Cir. 1999). The Fifth Circuit initially dismissed the appeal after concluding that appellate jurisdiction was lacking because the district court's order was not "final" within the meaning of 28 U.S.C. § 158(d). *Id.* at 629. The Fifth Circuit has since affirmed the district court's decision. *Caddo Parish-Villas S., Ltd. v. Beal Bank, S.S.B. (In re Caddo Parish-Villas S., Ltd.)*, 250 F.3d 300, 302 (5th Cir. 2001).

In *YYY Corp.*, Craig Krisel and William Volante executed a \$1,360,000 promissory note in 1985 that was payable to United Federal Bank.¹⁰⁶ In June 1986, Richard and Everette Gazda agreed to repay the note.¹⁰⁷ In 1987, the Gazdas executed a reform agreement with United Savings Bank (successor to United Federal Bank) and a \$369,202.53 promissory note.¹⁰⁸ In 1991, the FDIC assumed control of Dartmouth Bank (successor to United Savings Bank) and in 1996 sold both notes to YYY Corp. (YYY).¹⁰⁹ The FDIC could not locate the original notes, which had been lost by the FDIC or one of the previous holders; YYY received only copies of the two notes.¹¹⁰ When YYY sued the Gazdas to collect the deficiency balance, the trial court concluded that the 1987 note was a negotiable instrument, but held that YYY's lack of possession prevented enforcement under section 3-309.¹¹¹

The trial court also held that the FDIC could not assign its enforcement rights to YYY.¹¹² On appeal, the New Hampshire Supreme Court reversed the trial court's ruling that section 3-309 barred YYY's enforcement of a note that it never possessed.¹¹³ Noting that the FDIC could have enforced the note,¹¹⁴ the New Hampshire Supreme Court

106. *YYY Corp. v. Gazda*, 761 A.2d 395, 396 (N.H. 2000).

107. *Id.*

108. *Id.* at 396-97.

109. *Id.* at 397.

110. *Id.*

111. *Id.* at 398. The trial court held that YYY could enforce the 1985 note under the 1987 reform agreement, even absent possession of the lost note, because the liability no longer arose from the note itself. *Id.* Instead, liability was controlled by the reform agreement. *Id.* And as the reform agreement was not a negotiable instrument under Article 3, lack of possession of the original note did not bar enforcement. *Id.*

Applying Former Article 3, the New Hampshire Supreme Court affirmed the trial court's conclusion that the reform agreement was not governed by Article 3 because the agreement did not state an unconditional promise to pay and was not payable to order or to bearer. *Id.* at 398-99. The court applied the former version of Article 3 "since it governed negotiable instruments at the time of the execution of the [document] in question." *Id.* at 398 (quoting *Barnsley v. Empire Mortgage Ltd. P'ship V*, 720 A.2d 63, 64 (N.H. 1998)). Under Former Article 3, a writing is a negotiable instrument only if it is signed by the maker or drawer, contains an unconditional promise or order to pay a sum certain in money (and generally no other promise, order, obligation, or power), is payable on demand or at a definite time, and is payable to order or bearer. Former U.C.C. § 3-104(1). The court also could have reached the same conclusion under Revised Article 3. See U.C.C. § 3-104(a) (defining "negotiable instrument" as "an unconditional promise or order to pay a fixed amount of money" that also —among other requirements—"is payable to bearer or to order").

112. *YYY Corp.*, 761 A.2d at 400.

113. *Id.* The parties agreed that Revised Article 3 (and, therefore, section 3-309) applied because YYY had acquired the 1987 note after New Hampshire had adopted Revised Article 3. *Id.*; but see *supra* note 111 and accompanying text (discussing court's decision to apply the law in effect on the execution date).

114. *YYY Corp.*, 761 A.2d at 400-01. If the FDIC's predecessor, Dartmouth Bank, lost the note, then the FDIC succeeded to Dartmouth's enforcement rights under federal law. See *id.* (relying on 12 U.S.C. § 1821(d)(2)(A)(i) (1994), which states: "The [FDIC] shall, as conservator or receiver,

then examined whether the FDIC could assign its enforcement rights to YYY. The court noted that “[n]either the plain language nor the official comment to [section 3-309] supports the trial court’s determination that a person entitled to enforce a negotiable instrument cannot assign that right or that the intent behind section 3-309 was to displace the common law of assignments.”¹¹⁵ In accordance with section 1-103, the court examined New Hampshire assignment law, under which an assignee receives the rights of its assignor at the time of assignment.¹¹⁶ These rights, according to the court, included the FDIC’s enforcement rights under section 3-309.¹¹⁷ The court then held that YYY, as the FDIC’s assignee, could enforce the lost 1987 note.¹¹⁸

Section 1-103 states what has been referred to as the “Swiss cheese theory” of Code interpretation: “Regard the Code as a piece of Swiss cheese with all its holes, and if, when you search for a solution to your case, you find a hole in the Code, look through it to the backdrop of case law.”¹¹⁹ And, as happened in *Beal Bank* and *YYY Corp.*, courts that have addressed whether a party may enforce a lost instrument that it never possessed have concluded that the Code has a hole in it that can be filled by general assignment law.¹²⁰

But the hole disappears when three Article 3 provisions are examined collectively: sections 3-301, 3-309, and 3-203. Section 3-301 describes with particularity those parties that enjoy enforcement rights. Acknowledging that an instrument may be lost, stolen, or destroyed, section 3-301 conveys PETE status in the missing instrument to a party if that party can satisfy the three requirements of section 3-309. The first requirement, in unambiguous language, requires the party asserting

and by operation of law, succeed to—(i) all rights, titles, powers, and privileges of the insured depository institution . . .”). Alternatively, if the FDIC lost the note, it could have enforced the note under section 3-309. *Id.* at 401.

115. *Id.*

116. *See id.* (citing *Woodstock Soapstone Co. v. Carleton*, 585 A.2d 312, 316–17 (N.H. 1991)).

117. *Id.*

118. *Id.* But the supreme court remanded the matter to the trial court to address the requirement of adequate protection under section 3-309(b). *See id.* (concluding that the trial court had made no finding regarding the amount of the note to be collected).

119. E. Allan Farnsworth, *A Common Lawyer’s View of His Civilian Colleagues*, 57 LA. L. REV. 227, 231 (1996). Another author has used a different graphic image to describe the effect of section 1-103: “In other words, U.C.C. sections are ‘islands in an ocean of uncodified common law.’” Gerald T. McLaughlin, *Security Interests in Deposit Accounts: Unresolved Problems and Unanswered Questions Under Existing Law*, 54 BROOK. L. REV. 45, 48 n.11 (1988) (quoting JOHN O. HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION 62 (1982)).

120. *E.g.*, *Beal Bank, S.S.B. v. Caddo Parish-Villas S., Ltd.*, 218 B.R. 851, 855 (N.D. Tex. 1998), *aff’d*, 250 F.3d 300 (5th Cir. 2001); *YYY Corp.*, 761 A.2d at 401.

enforcement rights in the instrument to have been “in possession of the instrument and entitled to enforce it when loss of possession occurred.”¹²¹ Furthermore, Article 3 is not silent on the assignability of enforcement rights bestowed on parties under section 3-301. Section 3-203 states: “Transfer of an instrument . . . vests in the transferee any right of the transferor to enforce the instrument . . .”¹²² And section 3-203 leaves no room for doubt as to the meaning of “transfer of an instrument.” An instrument is transferred if, and only if, the transferor delivers—voluntarily transfers possession of—the instrument.¹²³ Section 3-203 simply does not permit the assignment of enforcement rights in a lost instrument. To reach a contrary result that rests on general assignment law incorporated through section 1-103 is to ignore that statute’s opening caveat—“Unless displaced by the particular provisions of this Act”—and to supplant, rather than supplement, Article 3 provisions that specifically address enforcement of lost instruments and assignment of enforcement rights.

B. PETEs, Possession, and Policy

Dennis Joslin and its progeny have struggled with the possession requirement of section 3-309, with mixed results. The cases have focused attention on *what* the statute says about possession without analyzing *why* the statute requires possession. As the preceding analysis concludes, the statutory language bars an assignee from enforcing an instrument that it never possessed. But examining the purpose of the possession requirement reveals that an assignor should be able to assign its enforcement rights in a lost, destroyed, or stolen instrument to an assignee.

As discussed in Part II, unless section 3-418(d) applies, a party cannot be a PETE under section 3-301 unless it (i) possesses the instrument at the time of enforcement or (ii) possessed a lost, destroyed, or stolen instrument and was entitled to enforce the instrument prior to its loss.¹²⁴ Professor Grant Gilmore sketched the historical background surrounding the importance of possession:

121. U.C.C. § 3-309(a)(i) (2000).

122. *Id.* § 3-203(b).

123. *See id.* § 3-203(a) (“An instrument is transferred when it is delivered . . .”); *id.* § 1-201(14) (defining “delivery” as the “voluntary transfer of possession”).

124. *Id.* § 3-301.

In putting together their law of negotiable instruments, the courts assumed that the new mercantile currency was a good thing whose use should be encouraged. Two quite simple ideas became the foundation pieces for the whole structure. One was the good faith purchase idea. . . . The other idea which, the first time you run into it, sounds like nonsense—the legal mind at its worst—was even more basic to the structure and indeed was what gave the completed edifice its pure and almost unearthly beauty. That was the idea that the piece of paper on which the bill was written or printed should be treated as if it—the piece of paper—was itself the claim or debt which it evidenced. This idea came to be known as the doctrine of merger—the debt was merged in the instrument. At one stroke it drastically simplified the law of negotiable instruments, to the benefit of both purchasers and the people required to pay the instruments. Under merger theory the only way of transferring the debt represented by the bill was by physical delivery of the bill itself to the transferee. The courts also worked out an elaborate set of rules on when the transferor was required to endorse, as well as deliver, the bill and on what liabilities to subsequent parties he assumed by endorsing. When these formalities—delivery and endorsement—had been accomplished—but not until then—the transfer became a negotiation and the transferee was a holder. Only the holder—the person physically in possession of the bill under a proper chain of endorsements—was entitled to demand payment of the bill from the party required to pay it; only payment to such a holder discharged the bill as well as the underlying obligation.¹²⁵

Section 3-301 recognizes this historical importance of possession by empowering holders, as well as nonholders in possession, with enforcement rights. But acknowledging human carelessness (as well as the criminal mind), section 3-301(iii) also permits parties to enforce lost, stolen, or destroyed instruments in limited situations.¹²⁶ This departure from the merger doctrine is noteworthy because an obligor is exposed to the considerable risk of being asked to pay the debt more than once if a party without possession of the instrument may rightfully demand payment. This could happen, for example, if a party lost an instrument bearing a blank indorsement.¹²⁷ The party without possession could enforce the instrument under section 3-301(iii) (via section 3-309) and the party that found the instrument could enforce it as a holder under

125. Grant Gilmore, *Formalism and the Law of Negotiable Instruments*, 13 CREIGHTON L. REV. 441, 448–50 (1979).

126. U.C.C. § 3-301(iii).

127. Any indorsement by a holder is either “special” or “blank.” An indorsement directing payment to another person (e.g., “Pay to Sue Smith”) is an example of a special indorsement. The indorser’s signature unaccompanied by other words is an example of a blank indorsement. *See generally id.* § 3-205(a)–(b) & cmts. 1–2 (explaining the difference between special and blank indorsements).

section 3-301(i).¹²⁸ Therefore, bestowing enforcement rights on a party that does not possess the instrument is ill-advised unless the obligor is protected against the risk of multiple payment.¹²⁹

Section 3-309(b) comes to the obligor's rescue by requiring a non-possessor to prove the terms of, and its right to enforce, the missing instrument.¹³⁰ Furthermore, a court may not enter judgment in favor of the non-possessor unless the court finds that the obligor "is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument."¹³¹ "Adequate protection" is a flexible concept and may be provided by any reasonable means (e.g., indemnification agreement, segregated cash account, etc.).¹³² Factors that may weigh on the court's decision include the degree of factual certainty in the case, the type of indorsement (if any) on the instrument, the financial strength of the party asserting enforcement rights, and the passage of time since the instrument was allegedly lost or stolen.¹³³

The protection afforded to an obligor by section 3-309(b) justifies extending enforcement rights to a party that does not possess the in-

128. Presentment of the instrument by the party in possession may terminate the non-possessor's ability to exercise any enforcement rights because the whereabouts of the instrument are ascertainable. See *id.* § 3-309(iii) (stating that a person not in possession may be entitled to enforce an instrument if it is destroyed, in the wrongful possession of an unknown person, or otherwise unobtainable). See also *Bank of America Nat'l Trust and Sav. Assoc. v. Allstate Ins. Co.*, 29 F. Supp. 2d 1129, 1144 (C.D. Cal. 1998) (finding party could not maintain action under section 3-309 after check was cashed).

129. An obligor that initially pays the non-possessor may assert the defense of prior payment when the possessor later asserts its enforcement rights. The defense of prior payment, however, is ineffective if the possessor is a holder in due course under section 3-302. See U.C.C. § 3-305(b) (stating that the enforcement rights of a holder in due course are subject only to the defenses of an obligor stated in section 3-302(a)(1), such as infancy, illegality, and duress).

130. *Id.* § 3-309(b); see also *Yanoff v. Muncy*, 688 N.E.2d 1259, 1262-63 (Ind. 1997) (concluding mortgagee could rely on mortgagor's admission of debt and its essential terms to satisfy burden of proof under Indiana's version of section 3-309(b)).

131. U.C.C. § 3-309(b). The concept of "adequate protection" has historical roots. See JAMES STEPHEN ROGERS, *THE EARLY HISTORY OF THE LAW OF BILLS AND NOTES: A STUDY OF THE ORIGINS OF ANGLO-AMERICAN COMMERCIAL LAW* 187 (J. H. Baker ed., 1995) ("There were also several cases in the late seventeenth and early eighteenth centuries that implicitly recognized the special rights of bona fide holders, in that they indicated that a person who had lost a bill of exchange or bank note could recover the money only if sufficient indemnity was given to protect against the risk that someone else might present the instrument.").

132. U.C.C. § 3-309(b) & cmt.

133. U.C.C. § 3-309 cmt.; see also *Kehoe v. Keister*, 727 F. Supp. 896, 898 (D.N.J. 1989) (refusing to require plaintiff to post security under predecessor statute to section 3-309 because no other party had asserted rights in a note lost for several years); *Nat'l Shawmut Bank v. Int'l Yarn Corp.*, 322 F. Supp. 116, 119 (S.D.N.Y. 1970) (requiring plaintiff bank merely to provide letter of indemnity under predecessor statute to section 3-309); CLARK & CLARK, *supra* note 23, ¶ 2.05[1], at 2-69 (suggesting a court should require security when a check payable to "cash" is stolen, but proposing a court might require no security if a check payable to a named payee is stolen before being indorsed by the payee).

strument. But as written, section 3-309(a) does not grant enforcement rights to all non-possessor parties. Instead, section 3-309(a) extends enforcement rights only to a non-possessor that previously possessed the instrument and was entitled to enforce it under section 3-301 when loss of possession occurred.¹³⁴ As has been revealed by *Dennis Joslin* and its progeny of cases, a purchaser of an already-lost instrument is not expressly permitted by section 3-309(a)(i) to enforce the instrument because the purchaser was not in possession “when loss of possession occurred.”¹³⁵ But why distinguish between non-possessors who had possession and non-possessors who never had possession, and empower the former—but not the latter—with enforcement rights? As noted (ironically) by the court in *Dennis Joslin*, “there does not appear to be a logical reason” for this distinction.¹³⁶

Enforcement of a lost, stolen, or destroyed instrument raises three genuine concerns. First, an obligor may be confronted with demands for payment by more than one party and exposed to the risk of multiple payment. Second, the original existence of the instrument may be challenged and its terms debated, raising difficult evidentiary issues. And third, parties with no legitimate claim to the instrument may fraudulently assert enforcement rights. These concerns are present every time a non-possessor party seeks to enforce a lost instrument, whether or not the non-possessor ever possessed the instrument. Each of these concerns, however, is specifically addressed by section 3-309(b). Under that section, a court cannot enter judgment in favor of a non-possessor party unless the court concludes that the obligor “is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument.”¹³⁷ Additionally, section 3-309(b) requires the non-possessor to “prove the terms of the instrument and [the non-possessor’s] right to enforce the instrument.”¹³⁸

Article 3 confronts each risk triggered by the enforcement of a lost, destroyed, or stolen instrument. These risks are present whether or not the non-possessor ever possessed the instrument. Therefore, conditioning the grant of enforcement rights in missing instruments on prior possession serves no purpose.¹³⁹ Instead, every non-possessor, includ-

134. U.C.C. § 3-309(a)(i).

135. *Id.*

136. *Dennis Joslin Co. v. Robinson Broad. Corp.*, 977 F. Supp. 491, 495 (D.D.C. 1997).

137. U.C.C. § 3-309(b).

138. *Id.*

139. See Veltri, *supra* note 67, at 1791 (“There is, in short, no reason to limit the reach of [section 3-309] to persons who were in actual possession of an instrument before it was lost, stolen, or

ing a party that never had possession, should be permitted to enforce a missing instrument if the proof and protection requirements of section 3-309(b) are met. Thus, from a policy perspective, an assignee of a lost, destroyed, or stolen instrument should be able to assert the enforcement rights of its assignor.

C. Using the Code to Reach a Proper Result: Section 1-103 Revisited

The task for future courts is to reach this policy-oriented result without erroneously relying on the shelter doctrine of section 3-203¹⁴⁰ or wrongfully incorporating general assignment law via section 1-103 to fill a non-existing statutory gap.¹⁴¹ What follows is a proposed analytical path relying on a particular statutory provision, the choice of which may seem surprising in light of earlier criticism of its use.

Section 1-103 states: "Unless displaced by the particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions." As noted by one author, "[t]he crucial issue here, of course, is determining the meaning of 'displaced.'"¹⁴² Proper resolution of that issue significantly turns on whether one seeks to apply principles of law or principles of equity. Professors White and Summers comment on the distinction:

The relations between general equitable principles and Code provisions are quite unlike the relations between general legal principles and Code provisions. One primary function of the corpus of Code sections is generally to displace prior legal principles. But it is not a primary function of these sections to displace prior equitable principles. To put this another way, Code sections "occupy the legal field" except insofar as they do not "particularly" displace pre-existing legal principles. But it is wrong to think of the relation between Code sections and general equitable principles in this way. Code sections do not "occupy the equity field." Rather, general equitable principles remain largely intact, for they are only rarely "particularly displaced." In a sense, then, they are the main occupants of the relevant field. This follows from their basic character. Unlike general legal principles, they do not merely supplement Code sections; their function is also to carve exceptions from or otherwise modify Code sections, and the courts have recognized as much. These functions are not peculiar to the bearing of 1-103 equitable principles

destroyed.").

140. See *supra* Part III.A.2.

141. See *supra* Part III.A.3.

142. Dow & Ellis, *supra* note 91, at 798.

on Code rules; they are characteristic of the bearing of equitable principles upon legal rules throughout the law.¹⁴³

Because assignment principles are rooted in law, rather than equity,¹⁴⁴ courts should avoid applying assignment principles through section 1-103 if Code sections adequately address the pertinent issue. As observed earlier,¹⁴⁵ three statutory provisions in Article 3—sections 3-301, 3-309, and 3-203—collectively address enforcement rights in lost, destroyed, and stolen instruments and the transferability of those enforcement rights. Because these Code sections occupy the legal field on this issue and adequately displace general assignment principles, courts should not invoke and apply general assignment principles through section 1-103.

Notwithstanding the direction afforded by sections 3-301, 3-309, and 3-203, these statutes do not preempt general equitable principles. Therefore, a court's reliance on section 1-103 is not misplaced when its departure from Code provisions rests on equitable, rather than legal, principles. And one or more equitable doctrines do exist that permit a court to conclude that a party that never possessed a missing instrument may nevertheless enforce it.

Assume for the moment that the holding of *Dennis Joslin* is correct: absent prior possession, a purchaser-assignee cannot enforce a lost, destroyed, or stolen instrument.¹⁴⁶ Who, then, can enforce the instrument under Article 3? Only the person that "was in possession of the instrument and entitled to enforce it when loss of possession occurred."¹⁴⁷ But that person, the seller-assignor, has no interest in litigating enforce-

143. WHITE & SUMMERS, *supra* note 91, § 5, at 19–20. See also *Bluebonnet Warehouse Coop. v. Bankers Trust Co.*, 89 F.3d 292, 299 (6th Cir. 1996) (Merritt, C.J., dissenting) ("A primary function of any codification of common law, including the [Uniform Commercial] Code, is to displace prior legal rules. The same cannot be said of prior equitable principles."); Summers, *supra* note 91, at 936–37 (contending that the displacement proviso of section 1-103 "must necessarily operate far more frequently with respect to so-called general principles of law than with respect to general principles of equity. For it is the primary function of most Code provisions to displace preexisting general principles of law But it is not the primary function of the Code to displace general principles of equity.").

144. See, e.g., *WAMCO, III, Ltd. v. First Piedmont Mortgage Corp.*, 856 F. Supp. 1076, 1086 (E.D. Va. 1994) (referring to "the common law maxim that the assignee stands in the shoes of the assignor"); *Dependable Ins. Co. v. Landers*, 421 So. 2d 175, 179 (Fla. Dist. Ct. App. 1982) (noting "the common law rule regarding assignments, putting the assignee in the shoes of the assignor insofar as the asserted claims may defeat or reduce the assignee's claim against the debtor"); *Global Fin. Servs., Inc. v. Duttenehner*, 575 N.W.2d 667, 671 (N.D. 1998) (discussing the "common law on assignability of contract rights").

145. See *supra* notes 121–23 and accompanying text.

146. 977 F. Supp. 491, 495 (D.D.C. 1997).

147. U.C.C. § 3-309(a)(i) (2000).

ment of an instrument that it has sold for a negotiated price, especially if the party seeking enforcement is not the initial purchaser-assignee after the instrument has been lost, destroyed, or stolen.¹⁴⁸ Presumably the obligor received goods, services, or some other benefit in return for executing the instrument. If the party that lost possession will not enforce the instrument, and if that party's initial and subsequent assignees are statutorily barred from enforcing the instrument, then the instrument may never be enforced and the obligor is unjustly enriched at the expense of a party that gave value for rights in the indebtedness. To avoid this windfall, a court, relying on section 1-103, should invoke the equitable doctrines of unjust enrichment and subrogation.¹⁴⁹ Under the doctrine of unjust enrichment, the obligor must honor its obligation to pay for the goods, services, or other benefits received. And under the doctrine of subrogation, the purchaser-assignee is empowered with the enforcement rights held (directly or indirectly) by its seller-assignor.¹⁵⁰ When combined with the procedural safeguards of section 3-309(b), these equitable principles permit a court to reach a policy-oriented result that is statutorily sound.

IV. AMENDING U.C.C. ARTICLE 3

Some courts may evince "skeptical attitudes toward general equitable principles" and hesitate to travel an analytical path through section 1-103.¹⁵¹ Therefore, Article 3 should be amended to expressly address

148. In many cases, the party asserting enforcement rights in the lost instrument (*B*) purchased the instrument from the party that lost the instrument (*A*). *E.g.*, *Southeast Invs., Inc. v. Clade*, 40 U.C.C. Rep. Serv. 2d (West) 255, 256 (N.D. Tex. 1999), *aff'd*, 212 F.3d 595 (5th Cir. 2000); *Beal Bank, S.S.B. v. Caddo Parish-Villas S., Ltd.*, 218 B.R. 851, 852 (N.D. Tex. 1998), *aff'd*, 250 F.3d 300 (5th Cir. 2001). Occasionally, however, the facts require analysis of enforcement rights held by *B*'s initial transferee (*C*) and any subsequent transferees (*D*). *E.g.*, *Dennis Joslin Co. v. Robinson Broad. Corp.*, 977 F. Supp. 491, 495 (D.D.C. 1997).

149. These principles have been characterized as equitable. *See, e.g.*, 2 FRED F. LAWRENCE, EQUITY JURISPRUDENCE, §§ 621-54 (discussing subrogation); *id.* §§ 722-52 (discussing unjust enrichment) (1929). *See also* Summers, *supra* note 91, at 921 (noting the "antiwindfall principle," an equitable principle related to the unjust enrichment principle, "provides that, other things being equal, one party should not realize an unearned gain at another's expense, especially where the other is a deserving party"). Without mentioning "equity" or section 1-103, one recent decision relied on the "antiwindfall principle" to extend enforcement rights in a lost instrument to an assignee. *See Nat'l Loan Investors, L.P. v. Joymar Assocs.*, 767 So. 2d 549, 551 (Fla. Dist. Ct. App. 2000) ("We see no reason why this right of enforcement cannot be assigned when recognizing such a right would prevent defendants in foreclosure actions from receiving a windfall.").

150. Article 3 acknowledges that a party may be subrogated to another's rights but conditions subrogation on possession of the instrument. U.C.C. § 3-301 cmt. (stating that a "nonholder in possession of an instrument includes a person that acquired rights of a holder by subrogation").

151. *See* Summers, *supra* note 91, at 927-30 (discussing various reasons for such skepticism,

the enforcement of lost, destroyed, or stolen instruments by parties that never had possession. A committee is presently considering amendments to Article 3 (as well as Articles 4 and 4A).¹⁵² A recent draft of proposed amendments reveals that Article 3 will be revised to confront the problem. As rewritten, section 3-309(a) will state:

(a) A person not in possession of an instrument is entitled to enforce the instrument if (i) the person seeking to enforce the instrument (or a person from whom the person seeking to enforce the instrument has directly or indirectly acquired ownership of the instrument) was entitled to enforce it when loss of possession occurred, (ii) the loss of possession was not the result of a transfer by the person or a lawful seizure, and (iii) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.¹⁵³

Additionally, the Official Comment will explain the purpose for the amendment:

Subsection (a) is revised to provide a definitive rejection of the reasoning of *Dennis Joslin Co. v. Robinson Broadcasting Corp.*, 977 F. Supp. 491 (D.D.C. 1997). A transferee of a lost instrument need prove only that its transferor was entitled to enforce, not that the transferee was in possession at the time the instrument was lost.¹⁵⁴

As revised, section 3-309 will no longer prohibit enforcement of a lost, destroyed, or stolen instrument by a party that never possessed the instrument. If *A* loses a promissory note, *A* may attempt to enforce the lost note under the following language: "(i) the person seeking to enforce the instrument . . . was entitled to enforce it when loss of possession occurred."¹⁵⁵ If *A* has sold its ownership interest in the lost note to

which he finds unjustified).

152. The chair of the committee is Edwin E. Smith, and the reporter is Professor Ronald J. Mann. The committee's drafts of proposed amendments to Articles 3, 4, and 4A can be viewed by visiting http://www.law.upenn.edu/bll/ulc/ulc_frame.htm. Additional information about the revision process is available at <http://www.uccpayments.org>.

153. NATIONAL COUNSEL OF COMMISSIONERS ON UNIFORM STATE LAWS, DRAFTS AND FINAL ACTS: U.C.C. PAYMENT ARTICLES (ARTICLES 3-4-4A), FEBRUARY 2001 DRAFT § 3-309, available at http://www.law.upenn.edu/bll/ulc/ulc_frame.htm (last visited Oct. 5, 2001).

154. *Id.* (Reporter's Note). An earlier draft added an additional third sentence (since deleted): "The decision to revise the statute does not reflect a determination that *Joslin* was a correct interpretation of the old statute; it reflects the importance of clarity as to the correct interpretation" *Id.* (Reporter's Note) (proposed draft Aug. 2000).

155. *Id.* (proposed draft Feb. 2001).

B, then *B* may attempt to enforce the lost note under the following language: "(i) . . . a person [*A*] from whom the person seeking to enforce the instrument [*B*] has directly . . . acquired ownership of the instrument[] was entitled to enforce it when loss of possession occurred."¹⁵⁶ And if *B* sells its ownership interest in the lost note to *C*, then *C* may attempt to enforce the lost note under the following language: "(i) . . . a person [*A*] from whom the person seeking to enforce the instrument [*C*] has . . . indirectly acquired ownership of the instrument[] was entitled to enforce it when loss of possession occurred."¹⁵⁷ In each instance, if the party that lost possession of the instrument was a PETE at the time of loss (either as a holder under section 3-301(i) or a nonholder in possession with rights of a holder under section 3-301(ii)), then subsequent owners also may enjoy PETE status.¹⁵⁸ No longer will the ability to enforce a lost, destroyed, or stolen instrument require prior possession by the party seeking enforcement.¹⁵⁹

The amendment to section 3-309 is welcome, but it creates problems elsewhere that should be addressed. For example, when *A* transfers a promissory note to *B* for value, Article 3 requires *A* to make certain warranties to *B* (and, in some instances, to subsequent transferees).¹⁶⁰ One provision obligates *A* to warrant that it is a PETE¹⁶¹ because the purpose of the transaction is to give enforcement rights to *B*.¹⁶² *A* also warrants that the promissory note is not subject to any defense or claim in recoupment of any party that can be asserted against *A*¹⁶³ because, absent contrary agreement, *B* will "not undertake to buy an instrument that is not enforceable in whole or in part."¹⁶⁴ Furthermore, in order to avoid a fraud upon *B*,¹⁶⁵ *A* warrants that it has no knowledge that the maker is subject to an insolvency proceeding.¹⁶⁶

156. *Id.*

157. *Id.*

158. *Id.*

159. As amended, section 3-309(a) will permit results more consistent with those under its predecessor, former section 3-804 (permitting enforcement of a lost instrument by an "owner," whether or not the instrument was lost by the "owner" or a predecessor).

160. The warranties are codified at sections 3-416(a), 3-417(a) (applicable only to unaccepted drafts), and 3-417(d) (applicable to dishonored drafts and other instruments, including promissory notes). Almost identical warranties appear in U.C.C. Article 4. U.C.C. §§ 4-207(a), 4-208(a), and 4-208(d) (2000).

161. *Id.* §§ 3-416(a)(1), 3-417(d)(1).

162. *Id.* § 3-416 cmt. 1.

163. *Id.* § 3-416(a)(4).

164. *Id.* § 3-416 cmt. 3.

165. *Id.* § 3-416 cmt. 4.

166. *Id.* § 3-416(a)(5).

The policy reasons that justify these warranties do not disappear if the instrument is lost, destroyed, or stolen.¹⁶⁷ Therefore, absent a disclaimer,¹⁶⁸ a party that sells a lost, destroyed, or stolen instrument should be required to make the Code-imposed warranties to its purchaser. But unless Article 3 is amended, no statutory warranties will accompany the sale. Why? Because the warranties are triggered by a transfer of the instrument.¹⁶⁹ And as noted earlier, an instrument cannot be transferred absent delivery, which requires a transfer of possession.¹⁷⁰

To overcome this statutory barrier to the imposition of warranties on sales of lost, destroyed, or stolen instruments, section 3-203(a) should be amended to read as follows (new language in *italics*):

An instrument *that is not lost, destroyed, or stolen* is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument. *An instrument that is lost, destroyed, or stolen is transferred when ownership of the instrument is conveyed by a person other than its issuer for the purpose of giving to the person acquiring ownership of the instrument the right to enforce the instrument.*

As amended, section 3-203(a) would no longer make a voluntary change in possession the *sine qua non* of a transfer. Instead, the revised statute expands the applicability of transfer-based provisions—for example, the shelter doctrine in section 3-203(b) and the warranty provisions of sections 3-416 and 3-417—in an effort to accommodate the desired effect of amending section 3-309(a): bestowing PETE status on a party that

167. A party may be obligated to warrant that “all signatures on the instrument are authentic and authorized” and that “the instrument has not been altered.” *Id.* § 3-416(a)(2), (3). Similar warranties appear elsewhere. *See, e.g., id.* § 3-417(a)(2) (warranting “the draft has not been altered”); *id.* § 3-417(a)(3) (warranting “no knowledge that the signature of the drawer of the draft is unauthorized”); *id.* § 4-207(a)(2) (warranting “all signatures on the item are authentic and authorized”); *id.* § 4-207(a)(3) (warranting “the item has not been altered”); *id.* § 4-208(a)(2) (warranting “the draft has not been altered”); *id.* § 4-208(a)(3) (warranting “no knowledge that the signature of the purported drawer of the draft is unauthorized”). Once an instrument is lost, stolen, or destroyed, it may be unfair for a party to make a warranty premised on information often gleaned from the instrument itself. Perhaps any warranty made after the instrument is lost, stolen, or destroyed that concerns alterations and signatures should be subject to a knowledge requirement (e.g., “the warrantor has no knowledge that any signature on the instrument is not authentic or not authorized” and “the warrantor has no knowledge that the instrument has been altered”).

168. Transfer warranties under section 3-416 and section 4-207, and presentment warranties under section 3-417 and section 4-208, may be disclaimed if the instrument is not a check. *Id.* §§ 3-416(c), 3-417(e), 4-207(d), 4-208(e).

169. *See id.* § 3-416(a) (imposing warranties on a person who “transfers an instrument”); *id.* § 3-417(a)(ii) (requiring “a previous transferor” to warrant certain statements); *id.* § 3-417(d)(1) (obligating a “prior transferor” to warrant that it was a PETE). Identical, or very similar, language is found in U.C.C. Article 4. *E.g., id.* § 4-207(a); *id.* § 4-208(a), (d).

170. *See supra* notes 89–90 and accompanying text.

acquires ownership of an instrument previously lost, stolen, or destroyed.

The amendment to section 3-309(a) also will necessitate revising numerous provisions that use the verb “take” and its variations (e.g., “taken” and “taking”). For example, section 3-310 discusses the effect on the underlying obligation when an instrument is “taken.”¹⁷¹ As used in Article 3, an instrument is “taken” when one party voluntarily transfers possession to another.¹⁷² If PETE status is extended to a party that never possessed the instrument, then the concept of “taking” an instrument becomes troublesome. An instrument can be “taken” only prior to its loss; thereafter it cannot be “taken.” But after the instrument disappears, section 3-309(a), as amended, will permit a party to acquire ownership of the instrument.¹⁷³ Where appropriate, then, statutes should be revised in a manner that acknowledges that instruments can be “taken” and ownership of instruments can be “acquired.” Relevant parts of some of the affected statutes, as possibly amended (new language in *italics*), follow:

- Section 3-306: A person taking, *or acquiring ownership of*, an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument, its ownership, or its proceeds¹⁷⁴
- Section 3-310(b)(1): . . . if a note or an uncertified check is taken, *or the ownership of a note or an uncertified check is acquired*, for an obligation . . .
- Section 3-403(a): . . . an unauthorized signature is ineffective except as the signature of the unauthorized signer in favor of a person who in good faith pays the instrument or takes it, *or acquires its ownership*, for value.¹⁷⁵

171. See U.C.C. § 3-310(a) (“Unless otherwise agreed, if a certified check, cashier’s check, or teller’s check is taken for an obligation”); *id.* § 3-310(b) (“Unless otherwise agreed and except as provided in subsection (a), if a note or an uncertified check is taken for an obligation”).

172. See 6 HAWKLAND & LAWRENCE, *supra* note 19, § 3-310:1, at 396 (“‘Taking’ the instrument for the underlying obligation requires more than simply its delivery by the obligor to the obligee.”).

173. See *supra* note 153 and accompanying text.

174. Section 3-303(a)(5) should be amended in a similar manner.

175. Sections 3-404(a), 3-404(b)(2), 3-405(b) (first sentence), and 3-406(a) should be amended in a similar manner.

- Section 3-404(d): . . . if a person paying the instrument or taking it, *or acquiring its ownership*, for value or for collection fails to exercise ordinary care in paying, taking, *or acquiring ownership of*, the instrument¹⁷⁶
- Section 3-407(c): A payor bank or drawee paying a fraudulently altered instrument or a person taking it, *or acquiring its ownership*, for value, in good faith and without notice of the alteration, may enforce rights with respect to the instrument
- Section 3-416(b): A person to whom the warranties under subsection (a) are made and who took, *or acquired ownership of*, the instrument in good faith may recover from the warrantor¹⁷⁷
- Section 3-419(c): . . . the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken, *or ownership of the instrument was acquired*, by that person that the accommodation party signed the instrument for accommodation.¹⁷⁸

As amended, these statutes remain applicable when a party acquires ownership of, but does not “take,” an instrument, a possibility created by extending PETE status under revised section 3-309(a) to a party that never possessed a lost, destroyed, or stolen instrument.

V. CONCLUSION

Article 3 permits a party to enforce a negotiable instrument that is lost, destroyed, or stolen if—and only if—the party possessed the instrument and was entitled to enforce it when loss of possession occurred. Whether those enforcement rights may be assigned is an issue that has recently confronted several courts, which have traveled different analytical paths in reaching inconsistent results. One approach, supported by section 3-309's requirement of prior possession, bars an assignee from enforcing the instrument. But this approach completely ignores the policy underlying enforcement of lost, destroyed, or stolen instruments and the statutory protections afforded to obligors when non-possessors demand payment. Another view, founded on the shelter doctrine of section 3-203, concludes that a transferee may exercise the enforcement rights held by its transferor, notwithstanding the posses-

176. Sections 3-405(b) (second sentence) and 3-406(b) should be amended in a similar manner.

177. Sections 3-418(c) and 4-207(c) should be amended in a similar manner.

178. Section 3-310(b)(3) should be amended in a similar manner.

sion requirement of section 3-309. But the shelter doctrine does not apply unless the transferor voluntarily conveys to the transferee possession of the instrument. A third approach reaches the same result but bypasses section 3-203, instead relying on general assignment principles under section 1-103. Yet, sections 3-301, 3-309, and 3-203 unambiguously require a party seeking to enforce a lost, destroyed, or stolen instrument to have had possession of the instrument at some time, negating any conclusion that the common law of assignments has not been displaced by Code provisions.

A proposed amendment to section 3-309 will conclusively permit a party to enforce an instrument that it never possessed if the party acquired ownership of the instrument directly or indirectly from a party that was entitled to enforce the instrument when loss of possession occurred. But this extension of PETE status to non-possessors will have a ripple effect throughout Article 3. Further amendments to many possession-sensitive provisions, particularly those that apply when a transfer occurs (e.g., section 3-416) or an instrument is taken (e.g., section 3-310), should be seriously considered.

How soon the sponsors of the U.C.C. will finalize proposed amendments to Article 3 is unknown. And thereafter it may be some time before state legislatures enact some or all of the amendments.¹⁷⁹ Until the issue is resolved statutorily, courts will continue to wrestle with the enforcement of instruments by parties that never possessed them. Rather than follow existing precedent, courts are encouraged to invoke section 1-103 and extend enforcement rights to non-possessors on equitable principles. This result is statutorily sound and advances the policy underlying section 3-309.

179. Although the revision process was completed in 1990, numerous states did not enact Revised Article 3 until after 1994. Colorado, Delaware, Iowa, New Jersey, North Carolina, South Dakota, and Vermont enacted it in 1995; Alabama, Georgia, Tennessee, Texas, and Wisconsin enacted it in 1996; Kentucky and Maryland enacted it in 1997; Massachusetts enacted it in 1998; Rhode Island enacted it in 2001; New York and South Carolina have yet to enact it. State U.C.C. Variations, U.C.C. Rep. Serv. (CBC) at xix-xx (2000).