West's Wisconsin Statutes Annotated
Uniform Commercial Code (Ch. 401 to 420) (Refs & Annos)
Chapter 403. Uniform Commercial Code-- Negotiable Instruments (Refs & Annos)
Subchapter III. Enforcement of Instruments

W.S.A. 403.305

403.305. Defenses and claims in recoupment

Currentness

(1) Except as stated in sub. (2), the right to enforce the obligation of a party to pay an instrument is subject to the following:

(a) A defense of the obligor based on any of the following:

1. Infancy of the obligor to the extent that it is a defense to a simple contract.

2. Duress, lack of legal capacity or illegality of the transaction which, under other law, nullifies the obligation of the obligor.

3. Fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms.

4. Discharge of the obligor in insolvency proceedings.

(b) A defense of the obligor stated in another section of this chapter or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract.

(c) A claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time that the action is brought.

(2) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in sub. (1)(a), but is not subject to defenses of the obligor stated in sub. (1)(b) or claims in recoupment stated in sub. (1)(c) against a person other than the holder.

(3) Except as stated in sub. (4), in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, a claim in recoupment or a claim to the instrument under s. 403.306 of another person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not

obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(4) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under sub. (1) that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy and lack of legal capacity.

Credits

<<For credits, see Historical Note field.>>

Editors' Notes

UNIFORM COMMERCIAL CODE COMMENT

1. Subsection (a) states the defenses to the obligation of a party to pay the instrument. Subsection (a)(1) states the "real defenses" that may be asserted against any person entitled to enforce the instrument.

Subsection (a)(1)(i) allows assertion of the defense of infancy against a holder in due course, even though the effect of the defense is to render the instrument voidable but not void. The policy is one of protection of the infant even at the expense of occasional loss to an innocent purchaser. No attempt is made to state when infancy is available as a defense or the conditions under which it may be asserted. In some jurisdictions it is held that an infant cannot rescind the transaction or set up the defense unless the holder is restored to the position held before the instrument was taken which, in the case of a holder in due course, is normally impossible. In other states an infant who has misrepresented age may be estopped to assert infancy. Such questions are left to other law, as an integral part of the policy of each state as to the protection of infants.

Subsection (a)(1)(ii) covers mental incompetence, guardianship, ultra vires acts or lack of corporate capacity to do business, or any other incapacity apart from infancy. Such incapacity is largely statutory. Its existence and effect is left to the law of each state. If under the state law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against a holder in due course. If the effect is merely to render the obligation voidable at the election of the obligor, the defense is cut off.

Duress, which is also covered by subsection (a)(ii), is a matter of degree. An instrument signed at the point of a gun is void, even in the hands of a holder in due course. One signed under threat to prosecute the son of the maker for theft may be merely voidable, so that the defense is cut off. Illegality is most frequently a matter of gambling or usury, but may arise in other forms under a variety of statutes. The statutes differ in their provisions and the interpretations given them. They are primarily a matter of local concern and local policy. All such matters are therefore left to the local law. If under that law the effect of the duress or the illegality is to make the obligation entirely null and void, the defense may be asserted against a holder in due course. Otherwise it is cut off.

Subsection (a)(1)(iii) refers to "real" or "essential" fraud, sometimes called fraud in the essence or fraud in the factum, as effective against a holder in due course. The common illustration is that of the maker who is tricked into signing a note in the belief that it is merely a receipt or some other document. The theory of the defense is that the signature on the instrument is ineffective because the signer did not intend to sign such an instrument at all. Under this provision the defense extends to an instrument signed with knowledge that it is a negotiable instrument, but without knowledge of its essential terms. The test of the defense is that of excusable ignorance of the contents of the writing signed. The party must not only have been in ignorance, but must also have had no reasonable opportunity to obtain knowledge. In determining what is a reasonable opportunity all relevant factors are to be taken into account, including the intelligence, education, business experience, and ability to read or

understand English of the signer. Also relevant is the nature of the representations that were made, whether the signer had good reason to rely on the representations or to have confidence in the person making them, the presence or absence of any third person who might read or explain the instrument to the signer, or any other possibility of obtaining independent information, and the apparent necessity, or lack of it, for acting without delay. Unless the misrepresentation meets this test, the defense is cut off by a holder in due course.

Subsection (a)(1)(iv) states specifically that the defense of discharge in insolvency proceedings is not cut off when the instrument is purchased by a holder in due course. "Insolvency proceedings" is defined in Section 1-201(22) and it includes bankruptcy whether or not the debtor is insolvent. Subsection (2)(e) of former Section 3-305 is omitted. The substance of that provision is stated in Section 3-601(b).

2. Subsection (a)(2) states other defenses that, pursuant to subsection (b), are cut off by a holder in due course. These defenses comprise those specifically stated in Article 3 and those based on common law contract principles. Article 3 defenses are nonissuance of the instrument, conditional issuance, and issuance for a special purpose (Section 3-105(b)); failure to countersign a traveler's check (Section 3-106(c)); modification of the obligation by a separate agreement (Section 3-117); payment that violates a restrictive endorsement (Section 3-206(f)); instruments issued without consideration or for which promised performance has not been given (Section 3-303(b)), and breach of warranty when a draft is accepted (Section 3-417(b)). The most prevalent common law defenses are fraud, misrepresentation or mistake in the issuance of the instrument. In most cases the holder in due course will be an immediate or remote transferee of the payee of the instrument. In most cases the holder-in-due-course doctrine is irrelevant if defenses are being asserted against the payee of the instrument, but in a small number of cases the payee of the instrument may be a holder in due course. Those cases are discussed in Comment 4 to Section 3-302.

Assume Buyer issues a note to Seller in payment of the price of goods that Seller fraudulently promises to deliver but which are never delivered. Seller negotiates the note to Holder who has no notice of the fraud. If Holder is a holder in due course, Holder is not subject to Buyer's defense of fraud. But in some cases an original party to the instrument is a holder in due course. For example, Buyer fraudulently induces Bank to issue a cashier's check to the order of Seller. The check is delivered by Bank to Seller, who has no notice of the fraud. Seller can be a holder in due course and can take the check free of Bank's defense of fraud. This case is discussed as Case # 1 in Comment 4 to Section 3-302. Former Section 3-305 stated that a holder in due course takes free of defenses of "any party to the instrument with whom the holder has not dealt." The meaning of this language was not at all clear and if read literally could have produced the wrong result. In the hypothetical case, it could be argued that Seller "dealt" with Bank because Bank delivered the check to Seller. But it is clear that Seller should take free of Bank's defense against Buyer regardless of whether Seller took delivery of the check from Buyer or from Bank. The quoted language is not included in Section 3-305. It is not necessary. If Buyer issues an instrument to Seller and Buyer has a defense against Seller, that defense can obviously be asserted. Buyer and Seller are the only people involved. The holder-in-due-course doctrine has no relevance. The doctrine applies only to cases in which more than two parties are involved. Its essence is that the holder in due course does not have to suffer the consequences of a defense of the obligor on the instrument that arose from an occurrence with a third party.

3. Subsection (a)(3) is concerned with claims in recoupment which can be illustrated by the following example. Buyer issues a note to the order of Seller in exchange for a promise of Seller to deliver specified equipment. If Seller fails to deliver the equipment or delivers equipment that is rightfully rejected, Buyer has a defense to the note because the performance that was the consideration for the note was not rendered. Section 3-303(b). This defense is included in Section 3-305(a)(2). That defense can always be asserted against Seller. This result is the same as that reached under former Section 3-408.

But suppose Seller delivered the promised equipment and it was accepted by Buyer. The equipment, however, was defective. Buyer retained the equipment and incurred expenses with respect to its repair. In this case, Buyer does not have a defense under Section 3-303(b). Seller delivered the equipment and the equipment was accepted. Under Article 2, Buyer is obliged to pay the price of the equipment which is represented by the note. But Buyer may have a claim against Seller for breach of warranty. If Buyer has a warranty claim, the claim may be asserted against Seller as a counterclaim or as a claim in recoupment to reduce

the amount owing on the note. It is not relevant whether Seller is or is not a holder in due course of the note or whether Seller knew or had notice that Buyer had the warranty claim. It is obvious that holder-in-due-course doctrine cannot be used to allow Seller to cut off a warranty claim that Buyer has against Seller. Subsection (b) specifically covers this point by stating that a holder in due course is not subject to a "claim in recoupment * * * against a person other than the holder."

Suppose Seller negotiates the note to Holder. If Holder had notice of Buyer's warranty claim at the time the note was negotiated to Holder, Holder is not a holder in due course (Section 3-302(a)(2)(iv)) and Buyer may assert the claim against Holder (Section 3-305(a)(3)) but only as a claim in recoupment, i.e. to reduce the amount owed on the note. If the warranty claim is $1,000 and the unpaid note is $10,000, Buyer owes $9,000 to Holder. If the warranty claim is more than the unpaid amount of the note, Buyer owes nothing to Holder, but Buyer cannot recover the unpaid amount of the warranty claim from Holder. If Buyer had already partially paid the note, Buyer is not entitled to recover the amounts paid. The claim can be used only as an offset to amounts owing on the note. If Holder had no notice of Buyer's claim and otherwise qualifies as a holder in due course, Buyer may not assert the claim against Holder. Section 3-305(b).

The result under Section 3-305 is consistent with the result reached under former Article 3, but the rules for reaching the result are stated differently. Under former Article 3 Buyer could assert rights against Holder only if Holder was not a holder in due course, and Holder's status depended upon whether Holder had notice of a defense by Buyer. Courts have held that Holder had that notice if Holder had notice of Buyer's warranty claim. The rationale under former Article 3 was "failure of consideration." This rationale does not distinguish between cases in which the seller fails to perform and those in which the buyer accepts the performance of seller but makes a claim against the seller because the performance is faulty. The term "failure of consideration" is subject to varying interpretations and is not used in Article 3. The use of the term "claim in recoupment" in Section 3-305(a)(3) is a more precise statement of the nature of Buyer's right against Holder. The use of the term does not change the law because the treatment of a defense under subsection (a)(2) and a claim in recoupment under subsection (a)(3) is essentially the same.

Under former Article 3, case law was divided on the issue of the extent to which an obligor on a note could assert against a transferee who is not a holder in due course a debt or other claim that the obligor had against the original payee of the instrument. Some courts limited claims to those that arose in the transaction that gave rise to the note. This is the approach taken in Section 3-305(a)(3). Other courts allowed the obligor on the note to use any debt or other claim, no matter how unrelated to the note, to offset the amount owed on the note. Under current judicial authority and non-UCC statutory law, there will be many cases in which a transferee of a note arising from a sale transaction will not qualify as a holder in due course. For example, applicable law may require the use of a note to which there cannot be a holder in due course. See Section 3-106(d) and Comment 3 to Section 3-106. It is reasonable to provide that the buyer should not be denied the right to assert claims arising out of the sale transaction. Subsection (a)(3) is based on the belief that it is not reasonable to require the transferee to bear the risk that wholly unrelated claims may also be asserted. The determination of whether a claim arose from the transaction that gave rise to the instrument is determined by law other than this Article and thus may vary as local law varies.

4. Subsection (c) concerns claims and defenses of a person other than the obligor on the instrument. It applies principally to cases in which an obligation is paid with the instrument of a third person. For example, Buyer buys goods from Seller and negotiates to Seller a cashier's check issued by Bank in payment of the price. Shortly after delivering the check to Seller, Buyer learns that Seller had defrauded Buyer in the sale transaction. Seller may enforce the check against Bank even though Seller is not a holder in due course. Bank has no defense to its obligation to pay the check and it may not assert defenses, claims in recoupment, or claims to the instrument of Buyer, except to the extent permitted by the "but" clause of the first sentence of subsection (c). Buyer may have a claim to the instrument under Section 3-306 based on a right to rescind the negotiation to Seller because of Seller's fraud. Section 3-202(b) and Comment 2 to Section 3-201. Bank cannot assert that claim unless Buyer is joined in the action in which Seller is trying to enforce payment of the check. In that case Bank may pay the amount of the check into court and the court will decide whether that amount belongs to Buyer or Seller. The last sentence of subsection (c) allows the issuer of an instrument such as a cashier's check to refuse payment in the rare case in which the issuer can prove that the instrument is a lost or stolen instrument and the person seeking enforcement does not have rights of a holder in due course.

5. Subsection (d) applies to instruments signed for accommodation (Section 3-419) and this subsection equates the obligation of the accommodation party to that of the accommodated party. The accommodation party can assert whatever defense or claim the accommodated party had against the person enforcing the instrument. The only exceptions are discharge in bankruptcy, infancy and lack of capacity. The same rule does not apply to an endorsement by a holder of the instrument in negotiating the instrument. The endorser, as transferor, makes a warranty to the endorsee, as transferee, that no defense or claim in recoupment is good against the endorser. Section 3-416(a)(4). Thus, if the endorsee sues the endorser because of dishonor of the instrument, the endorser may not assert the defense or claim in recoupment of the maker or drawer against the endorsee.

Section 3-305(d) must be read in conjunction with Section 3-605, which provides rules (usually referred to as suretyship defenses) for determining when the obligation of an accommodation party is discharged, in whole or in part, because of some act or omission of a person entitled to enforce the instrument. To the extent a rule stated in Section 3-605 is inconsistent with Section 3-305(d), the Section 3-605 rule governs. For example, under Section 3-605(b), discharge under Section 3-604 of the accommodated party does not discharge the accommodation party. As explained in Comment 3 to Section 3-605, discharge of the accommodated party is normally part of a settlement under which the holder of a note accepts partial payment from an accommodated party who is financially unable to pay the entire amount of the note. If the holder then brings an action against the accommodation party to recover the remaining unpaid amount of the note, the accommodation party cannot use Section 3-305(d) to nullify Section 3-605(b) by asserting the discharge of the accommodated party as a defense. On the other hand, suppose the accommodated party is a buyer of goods who issued the note to the seller who took the note for the buyer's obligation to pay for the goods. Suppose the buyer has a claim for breach of warranty with respect to the goods against the seller and the warranty claim may be asserted against the holder of the note. The warranty claim is a claim in recoupment. If the holder and the accommodated party reach a settlement under which the holder accepts payment less than the amount of the note in full satisfaction of the note and the warranty claim, the accommodation party could defend an action on the note by the holder by asserting the accord and satisfaction under Section 3-305(d). There is no conflict with Section 3-605(b) because that provision is not intended to apply to settlement of disputed claims. Another example of the use of Section 3-305(d) in cases in which Section 3-605 applies is stated in Comment 4 to Section 3-605. See PEB Commentary No. 11, dated February 10, 1994.

TABLE OF JURISDICTIONS WHEREIN CODE HAS BEEN ADOPTED

Jurisdiction	Laws	Effective Date	Statutory Citation
Alabama	1965, Act No. 549	1-1-1967	Code 1975, §§ 7-1-101 to 7-11-108.
Alaska	1962, c. 114	1-1-1963	AS 45.01.101 to 45.08.511, 45.12.101 to 45.12.532, 45.14.101 to 45.14.507, and 45.29.101 to 45.29.709.
Arizona	1967, c. 3	1-1-1968	A.R.S. §§ 47-1101 to 47-11107.
Arkansas	1961, Act No. 185	1-1-1962	A.C.A. §§ 4-1-101 to 4-10-104.
California	Stats. 1963, c. 819	1-1-1965	West's Ann.Cal.Com.Code, §§ 1101 to 16104.

Colorado	1965, c. 330	7-1-1966	West's C.R.S.A. §§ 4-1-101 to 4-11-102.
Connecticut	1959, No. 133	10-1-1961	C.G.S.A. §§ 42a-1-101 to 42a-10-109.
Delaware	1966, c. 349	7-1-1967	6 Del.C. §§ 1-101 to 11-109.
District of Columbia	P.L. 88-243	1-1-1965	D.C. Official Code, 2001 Ed. §§ 28:1-101 to 28:11-108.
Florida	1965, c. 65-254	1-1-1967	West's F.S.A. §§ 670.101 to 670.507; 671.101 to 680.532.
Georgia	1962, Act 713	1-1-1964	Ga. Code Ann. §§ 11-1-101 to 11-12-102.
Hawaii	1965, No. 208	1-1-1967	HRS §§ 490:1-101 to 490:11-108.
Idaho	1967, c. 161	1-1-1968	I.C. §§ 28-1-101 to 28-12-532.
Illinois	1961, p. 2101	7-2-1962	S.H.A. 810 ILCS 5/1-101 to 5/13-103.
Indiana	1963, c. 317	7-1-1964	West's A.I.C. 26-1-1-101 to 26-1-10-104.
Iowa	1965, (61 G.A.) c. 413	7-4-1966	I.C.A. §§ 554.1101 to 554.13532.
Kansas	1965, c. 564	1-1-1966	K.S.A. 84-1-101 to 84-10-102.
Kentucky	1958, c. 77	7-1-1960	KRS 355.1-101 to 355.11-108.
Louisiana	1974, No. 92	1-1-1975	LSA-R.S. 10:1-101 to 10:9-710.

Maine	1963, c. 362	12-31-1964	11 M.R.S.A. §§ 1-101 to 10-108.
Maryland	1963, c. 538	2-1-1964	Code, Commercial Law, §§ 1-101 to 10-112.
Massachusetts	1957, c. 765	10-1-1958	M.G.L.A. c. 106, §§ 1-101 to 9-709.
Michigan	1962, P.A. 174	1-1-1964	M.C.L.A. §§ 440.1101 to 440.11102.
Minnesota	1965, c. 811	7-1-1966	M.S.A. §§ 336.1-101 to 336.11-108.
Mississippi	1966, c. 316	3-31-1968	Code 1972, §§ 75-1-101 to 75-11-108.
Missouri	1963, p. 503	7-1-1965	V.A.M.S. §§ 400.1-101 to 400.11-108.
Montana	1963, c. 264	1-2-1965	MCA 30-1-101 to 30-9A-709.
Nebraska	1963, c. 544	9-2-1965	Neb.U.C.C. §§ 1-101 to 10-104.
Nevada	1965, c. 353	3-1-1967	N.R.S. 104.1101 to 104.9709 and 104A.010 to 104A.4507.
New Hampshire	1959, c. 247	7-1-1961	RSA 382-A:1-101 to 382-A:9-710.
New Jersey	1961, c. 120	1-1-1963	N.J.S.A. 12A:1-101 to 12A:11-108.
New Mexico	1961, c. 96	1-1-1962	NMSA 1978, §§ 55-1-101 to 55-12-109.
New York	1962, c. 553	9-27-1964	McKinney's Uniform Commercial Code, §§ 1-101 to 13-105.

North Carolina	1965, c. 700	7-1-1967	G.S. §§ 25-1-101 to 25-11-108.
North Dakota	1965, c. 296	7-1-1966	NDCC 41-01-02 to 41-10-06.
Ohio	1961, p. 13	7-1-1962	R.C. §§ 1301.01 to 1310.78.
Oklahoma	1961, p. 70	1-1-1963	12A Okl.St.Ann. §§ 1-101 to 11-107.
Oregon	1961, c. 726	9-1-1963	ORS 71.1010 to 79.0628.
Pennsylvania	1953, P.L. 3	7-1-1954	13 Pa.C.S.A. §§ 1101 to 9710.
Rhode Island	1960, c. 147	1-2-1962	Gen.Laws 1956, §§ 6A-1-101 to 6A-9-710.
South Carolina	1966, c. 1065	1-1-1968	Code 1976, §§ 36-1-101 to 36-11-108.
South Dakota	1966, c. 150	7-1-1967	SDCL 57A-1-101 to 57A-11-108.
Tennessee	1963, c. 81	7-1-1964	T.C.A. §§ 47-1-101 to 47-9-710.
Texas	1965, c. 721	7-1-1966	V.T.C.A., Bus. & C. §§ 1.101 to 11.108.
Utah	1965, c. 154	1-1-1966	U.C.A.1953, 70A-1-101 to 70A-11-108.
Vermont	1966, No. 29	1-1-1967	9A V.S.A. §§ 1-101 to 9-709.
Virgin Islands	1965, No. 1299	7-1-1965	11A V.I.C. §§ 1-101 to 9-709.

Virginia	1964, c. 219	1-1-1966	Code 1950, §§ 8.1A-101 to 8.11-108.
Washington	1965, Ex.Sess., c. 157	7-1-1967	West's RCWA 62A.1-101 to 62A.11-113.
West Virginia	1963, c. 193	7-1-1964	Code, 46-1-101 to 46-11-108.
Wisconsin	1963, c. 158	7-1-1965	W.S.A. 401.101 to 411.901.
Wyoming	1961, c. 219	1-2-1962	Wyo.Stat.Ann. §§ 34.1-1-101 to 34.1-10-104.

Notes of Decisions (2)

W. S. A. 403.305, WI ST 403.305
Current through 2023 Act 140, except Acts 119-121, 126-128, 130-131, 135-138, published March 22, 2024.

End of Document