Whether a separate, unattached indorsement page can constitute a proper indorsement of a negotiable instrument is a question of state law. The parties concede there is no controlling precedent in any of the three relevant jurisdictions, but each state has adopted the Uniform Commercial Code. The briefs have not cited any case recounting facts close to those presented here,[fn2] nor has our independent research uncovered any such authority. We are left, therefore, largely to the wording of the Code itself.

[20] Article 3 of the Uniform Commercial Code incorporated many portions of its predecessor, the Uniform Negotiable Instruments Law (NIL), drafted in 1896 by the National Conference of Commissioners on Uniform State Laws. By 1924, the NIL had been adopted in every state. See 2 F. Hart & W. Willier, Commercial Paper Under the Uniform Commercial Code § 1.06, at 1-25 to -26 (1988). When it was transplanted into the 1956 draft of the Uniform Commercial Code, the indorsements provision was altered in only a minor respect. Section 31 of the NIL had specified that a proper indorsement "must be written on the instrument itself or upon a paper attached thereto." The Code substituted the words "so firmly affixed as to become a part thereof" for the phrase "upon a paper attached thereto."

[21] Indorsement constitutes one step in the process of establishing the highly advantageous position of holder in due course a status which cuts off certain defenses of previous parties to the instrument and which offers a procedural means for obtaining a judgment on the note promptly and inexpensively. See U.C.C. § 3-305. As a condition for conferring this privileged position, the Code not unreasonably imposes a number of prerequisites.

[22] A holder in due course must take the instrument for value, in good faith, and without notice that it is overdue, that it has been dishonored, or that a claim or defense to it exists on the part of any person. See U.C.C. § 3-302(1). But preliminarily, a person seeking to become a holder in due course must satisfy the threshold requirements for becoming a "holder," the critical issue on this appeal.

[23] The Code defines a holder as one "who is in possession of . . . an instrument . . . drawn, issued or indorsed to him or to his order." U.C.C. § 1-201(20). Mere ownership or possession of a note is insufficient to qualify an individual as a "holder." The instrument must be obtained through a process the Code terms "negotiation," defined as "the transfer of an instrument in such form that the transferee becomes a holder." U.C.C. § 3-202(1). If the instrument is payable to order — as is the case with the notes here — negotiation is accomplished "by delivery with any necessary indorsement." Id.

[24] In explaining the requirement that the indorsement be on or firmly affixed to the instrument, the Official Comment states that the Code "follows decisions holding that a purported indorsement on a mortgage or other separate paper pinned or clipped to an instrument is not sufficient for negotiation. The indorsement must be on the instrument itself or on a paper intended for the purpose which is so firmly affixed to the instrument as to become an extension or part of it. Such a paper is called an allonge." U.C.C. § 3-202 Official Code Comment (3).

[25] We may assume, without actually deciding, that the loose indorsement sheets accompanying Empire's notes would have been valid allonges had they been stapled or glued to the notes themselves. Cf. All American Finance Co. v. Pugh Shows, Inc., 30 Ohio St.3d 130, 507 N.E.2d 1134, 1136-37 n. 3 (1987) (collecting cases showing disagreement among courts on how firmly indorsements must be affixed). Nevertheless, the fact remains that the indorsement sheets here were not physically attached to the instruments in any way, and thus patently fail to comply with the explicit Code prerequisite. Conceding the requirement's formalistic nature, we explore the arguments in support of its enforcement here.

[26] The Code's requirement that an indorsement be "firmly affixed" to its instrument is a settled feature of commercial law, adopted verbatim by every American state, the District of Columbia, and the Virgin Islands. See 5 R. Anderson, Uniform Commercial Code § 3-202:2, at 416 (3d ed. 1984) (citing codifications). With a unanimity unusual in decisional law, the directive has been faithfully observed.[fn3]

[27] The historical origins of the provision have been chronicled to the days of the Law Merchant. See Pribus v. Bush, 118 Cal.App.3d 1003, 173 Cal.Rptr. 747, 749 (1981). The practice of multiple indorsements which accompanied the growth in commerce eventually led to acceptance of the use of allonges. See id.; Estrada v. River Oaks Bank & Trust Co., 550 S.W.2d 719, 725 (Tex.Civ.App. — Houston [14th Dist.] 1977, writ ref'd n.r.e.). Even today, however, numerous jurisdictions permit allonges only where, because of multiple indorsements, no additional space for signatures remains on the negotiable instrument. See, e.g., Pribus, 173 Cal.Rptr. at 751; Tallahassee Bank & Trust Co. v. Raines, 125 Ga. App. 263, 187 S.E.2d 320, 321 (1972). But see Crosby v. Roub, 16 Wis. 616, 626-27 (1863) (allonge permitted even where space remains on note).

[28] When the drafters of the Uniform Commercial Code replaced the term "attached" in the NIL with the phrase "firmly affixed," they intended to make the use of allonges more difficult. See Hills v. Gardiner Savings Institution, 309 A.2d 877, 880-81 (Me. 1973);

Estrada, 550 S.W.2d at 728; 5 Anderson, supra, § 3-202:05. Courts have advanced two justifications for the firmly-affixed requirement. The California Court of Appeals reasoned that the provision serves to prevent fraud, remarking that a signature innocently placed upon an innocuous sheet of paper could be fraudulently attached to a negotiable instrument in order to simulate an indorsement. Pribus, 173 Cal.Rptr. at 750. But cf. Lamson v. Commercial Credit Corp., 187 Colo. 382, 531 P.2d 966, 968 (1975) (allonge consisting of two legal sheets stapled to two small checks held valid because signing on checks themselves would have been impossible; "stapling is the modern equivalent of gluing or pasting").

[29] The affixation requirement has also been cited for its utility in preserving a traceable chain of title, thus furthering the Code's goal of free and unimpeded negotiability of instruments. Nearly a century ago, the Supreme Court of Georgia declared it "indispensably necessary" that negotiable instruments "should carry within them the indicia by which their ownership is to be determined; otherwise, their value as a circulating medium would be largely curtailed, if not entirely destroyed." Haug v. Riley, 101 Ga. 372, 29 S.E. 44, 46

(1897). See also Crosby, 16 Wis. at 627 (permanently attached indorsements to instrument "travel with it wherever it might go"). Chancellor Hawkland writes that it would be "unreasonable to impose upon the indorsee the risk that the present holder or a prior holder had negotiated the instrument to someone not in the apparent chain of title by virtue of a separate document." 4 W. Hawkland & L. Lawrence, Uniform Commercial Code Series § 3-202:05 (1984).

[30] Defendant here argues that these considerations warrant enforcement of the requirement only against those persons who acquire the notes after issuance, not against the makers who undertook to repay the amount loaned by the bank. This argument overlooks the rights which pass to an indorsee. Through effective negotiation, the indorsee becomes a holder, acquiring the authority to discharge the obligation on the note by accepting payment. See U.C.C. § 3-301. Until the maker pays a holder, he will not be discharged from his obligation. Thus, "if the primary party pays an instrument bearing an improper indorsement, he will not have paid a holder, and the true owner of the instrument may recover against the primary party." See 1 R. Aldermann, A Transactional Guide to the Uniform Commercial Code 633 n. 294 (2d ed. 1983).

[31] From the maker's standpoint, therefore, it becomes essential to establish that the person who demands payment of a negotiable note, or to whom payment is made, is the duly qualified holder. Otherwise, the obligor is exposed to the risk of double payment, or at least to the expense of litigation incurred to prevent duplicative satisfaction of the instrument. These risks provide makers with a recognizable interest in demanding proof of the chain of title. Consequently, plaintiffs here, as makers of the notes, may properly press defendant to establish its holder status.

[32] Plaintiffs have another reason for insisting on compliance with the Code's indorsement requirements. They allege their notes were procured by fraud and they wish to assert that as a defense to payment. As the Code provisions have been interpreted, however, the defense of fraud in the inducement is not available against holders in due course. See 6 Anderson, supra, § 3-305:62. Thus, if Empire successfully establishes its status as a holder in due course, it will be able to expeditiously fend off the plaintiffs' fraud allegations and obtain a judgment on the notes.

[33] Notwithstanding these concerns, defendant maintains that mere "clerical oversight" should not obscure its right to recover as a holder in due course on notes it purchased for value. There is some equitable appeal to this line of reasoning, but overriding considerations militate against it.

[34] We must be mindful of the limitations imposed on federal courts sitting in diversity. Where an appeal to this court challenges an application of state law, we are not free to indulge our preferences as to how the common law should best develop. Falcone v. Columbia Pictures Indus., 805 F.2d 115, 118 (3d Cir. 1986). When, as here, no controlling state case law guides our consideration, we are left to the "unenviable task" of predicting how the highest courts of Connecticut, New Hampshire, and New Jersey would rule were the question now

before them — a review decried as “omniscient in a way that is not possible for mortals.” Santiago v. Johnson Mach. & Press Corp., 834 F.2d 84, 84 (3d Cir. 1987).

[35] Fortunately, our review in this case does not demand such clairvoyance. When interpreting the attachment requirement, the courts “have been of one mind” that the lack of an indorsing signature on the instrument itself, or on a sheet “firmly affixed” to the instrument, is fatal to holdership. See, e.g., Bailey v. Mills, 257 Ala. 239, 58 So.2d 446, 447 (1952); Lopez v. Puzina, 239 Cal.App.2d 708, 49 Cal.Rptr. 122, 124-25 (1966); Lamson, 531 P.2d at 968; Shepherd Mall State Bank v. Johnson, 603 P.2d 1115, 1118 (Okla. 1979); Estrada, 550 S.W.2d at 725; Crossland Sav. Bank FSB v. Constant, 737 S.W.2d 19 (Tex.Ct.App. Corpus Christi 1987); Crosby, 16 Wis. at 627. As one treatise states, “[t]he unanimity of the courts in cases where the signature is separate from the instrument can be explained by a judicial perception that it is sound policy to require the indorsement to be on the instrument.” R. Hillman, J. McDonnell, & S. Nickles, Common Law and Equity Under the Uniform Commercial Code ¶ 11.02[1][b], at 11-18 (1985).

[36] Where the state courts, the scholarly commentators, and the unambiguous language of the statute all admit of but one result, only an overwhelming equitable ground would warrant a departure from what is unquestionably settled law. Absent such a circumstance, the Code’s express goal of national uniformity must prevail. See U.C.C. § 1-102(2).

[37] One premise underlying the defendant’s position on appeal is that plaintiff makers, once they give up possession of the instruments, lack standing to contest subsequent developments occurring in the course of later negotiations. Yet, as we have seen, the obligors have a very real interest in determining whether the person demanding payment on the note is actually a holder.

[38] The defendant’s attempt to distinguish the district court’s holding from the great weight of contrary precedent is similarly unpersuasive. Defendant argues that its indorsement sheets serve no collateral purpose other than to negotiate the notes, and that section 3-202(2) was intended only to prevent giving legal effect to purported indorsements contained in collateral purpose documents — such as mortgages and guaranties. This contention has been rejected by courts that have denied holder status to transferees relying on plain, unattached indorsement sheets. See Pribus, 173 Cal.Rptr. at 748; Duxbury v. Roberts, 388 Mass. 385, 446 N.E.2d 401, 403 (1983). Moreover, the same goals prompting adoption of the provision — prevention of fraud and ensuring an attached chain of title record — are equally served in applying the requirement here.

[39] Empire is not in a strong position to justify equitable relaxation of a settled formality in the Code. That longstanding provision was enacted, after all, for the benefit of parties in Empire’s position, commercial sophisticates that trade in the secondary market for negotiable instruments.[fn4] The provision is not ambiguous, nor can Empire assert excusable ignorance of an unusual local technicality, given the rule’s universal application. The flaws in the notes should have been perceived quickly and readily cured. Instead, the record suggests that the failure to observe that Code formality was caused by nothing short of sheer carelessness.

[40] Financial institutions, noted for insisting on their customers' compliance with numerous ritualistic formalities, are not sympathetic petitioners in urging relaxation of an elementary business practice. It is a tenet of commercial law that "[h]oldership and the potential for becoming holders in due course should only be accorded to transferees that observe the historic protocol." Hillman, McDonnell, & Nickles, supra, at ¶ 11.02[1][b], at 11-17. In sum, we are not persuaded that defendant presents a credible case for nonapplication of the plain wording of the state statutes.