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a new question for the Court. There, there was a distinct finding of equality in physical facilities, coupled with a finding that segregation has a detrimental effect upon Negro children since ". . . separating the races is usually interpreted as denoting the inferiority of the Negro group." [81] This finding is apparently in direct conflict with the basic fact principle of the "separate but equal" doctrine. Nevertheless, if the Court chooses, it may escape the necessity of a direct ruling on the validity of segregation per se, and decide the issues on the rationale of the *McLaurin* decision. The right of "intellectual commingling" which was there said to be an element of equality on the graduate school level, can logically, and should properly, be extended to education on the lower academic planes.

Perhaps, however, the Court will choose to rule directly on the applicability of the "separate but equal" doctrine. There is some evidence that it is not yet willing to go that far.[82] It would seem, however, that it cannot avoid the issues altogether. The District Court has found as a fact that the effects of enforced segregation are detrimental and hence discriminatory. It has nevertheless refused to restrain the discrimination. If, as was said in *Yick Wo v. Hopkins*,[83] ". . . the equal protection of the laws is a pledge of the protection of equal laws . . . ," [84] the Supreme Court cannot acquiesce in the inconsistency.

JUS TERTII UNDER COMMON LAW AND THE N.I.L.

Introduction

A *jus tertii* situation arises when the defendant has no defense of his own but wishes to defeat the plaintiff's action by alleging a defect in the plaintiff's title or the fact that the plaintiff has no title at all. The defendant, in substance, admits that he owes the debt sued on, but denies that he owes it to this plaintiff because of some outstanding right in a third person. When such a situation occurs many problems manifest themselves. The purpose of this article is to present the basic fact situations in which these problems arise and to attempt to clarify the status of the law in this respect through an analysis both of judicial opinions and relevant sections of the Negotiable Instruments Law.

Some sections of the New York Negotiable Instruments Law specifically forbid the use of *jus tertii*. For example, Section 41

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[81] See note 74 *supra*.
[82] See note 57 *supra*.
[83] 118 U. S. 356 (1886).
[84] *Id.* at 369.

states that the indorsement of an infant or corporation passes the *property* in the instrument, notwithstanding the fact that from want of capacity the corporation or infant may incur no liability on the instrument. This section, in effect, prohibits a defendant from setting up the incapacity of the plaintiff's indorser. Likewise, Section 110 provides that the maker of a promissory note cannot deny the existence of the payee and his then capacity to indorse.[1] Section 111 makes the same restraint applicable to the drawer of a bill of exchange. Section 112 applies to an acceptor and provides that he admits the existence of the drawer, the genuineness of his signature and his capacity and authority to draw the instrument. The acceptor under this latter section also admits the existence of the payee and his capacity to indorse. The prohibitions mentioned under the foregoing provisions thereby prevent a defendant from alleging prior defects in the plaintiff's title in the specific instances embraced within these provisions.[2]

The sections of the N.I.L. discussed above, however, fall far short of covering other important situations in which a *jus tertii* may occur. For purposes of clarity these situations may be divided into three separate categories: (1) Cases in which there is an equitable right of restitution in a third person; (2) Instances in which a third person has legal title to the instrument; and (3) The problem that arises when illegality has tainted the transfer between indorsers.

Equitable Right of Restitution in a Third Person

When through fraud a party is induced to part with a negotiable instrument, he may be said to have an equitable right of restitution in the instrument. In such case, legal title passes to the wrongdoer, and an equitable title remains in the defrauded party.[3]

At common law in New York equitable rights of a third party could not generally be invoked by one who was being sued on a negotiable instrument[4] ". . . unless the possession of the notes by the plaintiff [was] mala fides and [would] work some prejudice to the defendant. . . ."[5] The leading case of *Hays v. Hathorn*[6] sustained

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[1] Allison Hill Trust Co. v. Sarandrea, 134 Misc. 566, 236 N. Y. Supp. 265 (Sup. Ct. 1929).

[2] See BRITTON, BILLS AND NOTES §§ 159, 160 (1943).

[3] Prouty v. Roberts, 6 Cush. 19 (Mass. 1850); Bowles v. Oakman, 246 Mich. 674, 225 N. W. 613 (1929).

[4] Hays v. Hathorn, 74 N. Y. 486 (1878); City Bank of New Haven v. Perkins, 29 N. Y. 554 (1864); Guernsey v. Burns and Graves, 25 Wend. 411 (N. Y. 1841). *Contra:* Parsons v. Utica Cement Mfg. Co., 80 Conn. 58, 66 Atl. 1024 (1907), *aff'd*, 82 Conn. 333, 73 Atl. 785 (1909).

[5] Aspinwall v. Meyer, 2 Sandf. 180, 188 (N. Y. 1848), *aff'd, sub nom.* Howland and Aspinwall v. Myer, 3 N. Y. 290 (1850); *cf.* Guernsey v. Burns and Graves, 25 Wend. 411 (N. Y. 1841); Jones v. Central Hanover and Trust Co., 110 Fla. 69, 147 So. 895 (1933).

[6] 74 N. Y. 486 (1878).

this general proposition on the reasoning that if the plaintiff had the legal title to the instrument this title alone would be sufficient to make the plaintiff the real party in interest. Hence, this plaintiff would be the party entitled to sue on the note, irrespective of any equities that might exist between himself and his transferor.[7] Another reason given for not allowing the defense of equitable title in a third person is the possibility that the defendant may escape liability altogether, for if the third person has not voluntarily joined in the action, there is at least a presumption that he will not sue. This was recognized in an early New York Court of Appeals case, the court saying: ". . . should he [the defendant] succeed in defending . . . he may escape the payment of a just debt altogether. . . . It will be time enough to determine whether any other person has a better title, when such person shall come before the court to claim the bills in question. . . ." [8]

The courts nevertheless realized that, in some instances, justice would require that a defendant should be given an opportunity to prove that some third person held an outstanding equitable title in the instrument. Hence, in *Bowles v. Oakman,*[9] the court by way of *dicta* stated that a defendant may set up equities of a third person when his only purpose in so doing is to show that the plaintiff is not a holder in due course, thus opening the way for personal defenses of his own.[10] And, in New York, it was held that a plaintiff who had acquired an instrument by fraud could not maintain an action on it against any of the parties to the note. The reasoning of the court was as follows: "This proceeds on the general doctrine, that no man can acquire a right by his own fraud, to sustain an action in any court . . . ." [11] At first glance this case would seem to sustain the proposition that a defendant may set up the equitable interest of a third person even though the defendant has no personal defense of his own on the instrument. However, on a closer analysis, it will be noted that in this case the maker impleaded the person defrauded, and it was this defrauded person who actually set up the defense. Hence, in reality this case established an exception to the general common law rule, to wit: if the third party is before the court he is permitted to raise the defense of equitable title in himself. This exception has been approved and followed in most jurisdictions.[12]

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[7] *See* Hays v. Hathorn, 74 N. Y. 486, 490 (1878).

[8] City Bank of New Haven v. Perkins, 29 N. Y. 554, 567 (1864).

[9] 246 Mich. 674, 225 N. W. 613 (1929).

[10] Bowles v. Oakman, 246 Mich. 674, 225 N. W. 613 (1929) (In this case the defendant maker had no defense of his own, and therefore the court did not allow him to set up the equitable right of a third person.); City of Lakeland v. Select Tenures, Inc., 129 Fla. 338, 176 So. 274 (1937); Orleck v. Nemtzow, 59 R. I. 284, 195 Atl. 234 (1937).

[11] Talman v. Gibson, 1 Hall 308, 312 (N. Y. 1828).

[12] *E.g.,* Horrigan v. Wyman, 90 Mich. 121, 51 N. W. 187 (1892); Merchants' Exchange National Bank v. New Brunswick Savings Institution, 33 N. J. L. 170 (Sup. Ct. 1868).

Under the present Negotiable Instruments Law the defense of equitable title in a third person will not be allowed as against a holder in due course, for under Section 96 such a holder takes free and clear of all prior defects in title.[13] It is also to be noted that there is no section in the N.I.L. which specifically allows the defense against other holders. In ascertaining the law dealing with ordinary holders, it is necessary to review several sections of the N.I.L. which indirectly deal with the problem. Section 200 enumerates the methods by which a negotiable instrument may be discharged. One of them is payment *in due course* by or on behalf of the principal debtor.[14] However, Section 148 provides that payment *in due course* is made at or after maturity to the holder thereof in good faith and *without notice that his title is defective.* It would follow that if a defendant knew of prior equities, his payment would not be in due course, and hence, he would be running the risk of a subsequent suit on the same instrument. Therefore, Section 148 affords a strong argument in favor of allowing the defendant to raise this defense; for otherwise he may be subjected to double liability.

But on the other hand, Section 98 of the N.I.L. would seem to justify an argument for denying the defense. As previously stated, the defendant could have the third person joined in the action and have him set up the defense himself, thereby making the judgment binding on him.[15] Section 98 would appear to recognize this possibility. This section reads as follows: ". . . when it is shown that the title of any person who has negotiated the instrument was defective, the burden is on the holder to prove that he or some person under whom he claims acquired the title as holder in due course. But the last mentioned rule does not apply in favor of a party who became bound on the instrument prior to the acquisition of such defective title."[16] This latter sentence deals with a situation in which the defendant has no personal defense of his own on the instrument. The inference thus arises that the defendant's only purpose in showing that the plaintiff is not a holder in due course is to implead a third person who could set up such a defense. Therefore, carrying this inference further, since this third person can be impleaded to raise the defense himself, the defendant should not be permitted to raise this defense if he does not implead the third party.

The one New York case decided under the N.I.L. held, in effect, that a defendant sued on a negotiable instrument could only show that plaintiff had no title whatsoever to the instrument, thus, by in-

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[13] N. Y. NEG. INST. LAW § 96. "A holder in due course holds the instrument free from any defect of title of prior parties and free from defenses available to prior parties among themselves. . . ."

[14] N. Y. NEG. INST. LAW § 200. "A negotiable instrument is discharged: 1. By payment in due course by or on behalf of the principal debtor. . . ."

[15] See note 12 *supra.*

[16] N. Y. NEG. INST. LAW § 98.

ference, precluding the defense of equitable title in a third person.[17] In light of the foregoing provisions of the N.I.L. and the one case decided since its adoption, one may conclude that the result of the earlier common law cases would most likely remain intact today.[18]

Legal Title in a Third Person

Even at common law courts recognized that a plaintiff having no title at all is not entitled to sue, and that such lack of legal title may be pleaded by the defendant.[19] The reason for such a rule is that the plaintiff, if he has no legal title, is not the proper party to sue.[20] Furthermore, a defendant paying such a plaintiff would run the risk of double liability by a suit on behalf of the holder of the legal title.

Under the N.I.L. it is necessary to make a distinction between order paper and bearer paper. An order instrument must be indorsed to be further negotiated. The indorsement of a stolen or found instrument must of necessity be a forgery, since not made by the party named in the instrument. Section 42 of the N.I.L. specifically declares that such an instrument is inoperative in the hands of any holder.[21] This section thereby precludes even a holder in due course from suing on a forged instrument.

If the instrument is a bearer instrument, that is, can be negotiated by mere delivery, a different rule applies. Although the finder or thief, or persons taking with knowledge of such facts, cannot sue on the instrument, a holder in due course may. This follows from the protection afforded by the N.I.L. to holders in due course.[22] A holder in due course takes free from prior defects in title, except, as above stated, in forgery cases.[23] All these above instances are forms of *jus tertii* in which the defendant would plead the plaintiff's lack of legal title as a bar to his recovery. As has been seen, the law in these specific cases, is settled by the provisions of the N.I.L., and, therefore, no further discussion is necessary.

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[17] Adamson v. Adamson, 251 App. Div. 187, 295 N. Y. Supp. 506 (2d Dep't 1937).

[18] See BRITTON, BILLS AND NOTES 758 (1943).

[19] Hays v. Hathorn, 74 N. Y. 486 (1878).

[20] Lum v. Robertson, 6 Wall. 277 (U. S. 1867); Bond v. Maxwell, 40 Ga. App. 679, 150 S. E. 860 (1929); Richards v. Betzer, 53 Ill. 466 (1870). *Contra:* Hudson and Stokes v. Weir and Tate, 29 Ala. 294 (1856); Guest v. Rhine, 16 Tex. 549 (1856).

[21] N. Y. NEG. INST. LAW § 42. "Where a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against *any* party thereto, can be acquired through or under such signature. . . ." (Italics added.)

[22] See note 13 *supra.*

[23] See note 21 *supra.*

Illegality of Transfer Between Indorsers

Under New York statutes any negotiable instrument that is usurious in its inception is absolutely void,[24] even in the hands of a holder in due course.[25] The same is true of instruments that are originally issued to pay off a gambling debt.[26] However, the subject of discussion under this subdivision is of a different nature. Suppose that maker *M* issues a completely valid negotiable instrument to payee *P*. *P* thereafter gets involved in a game of cards with *W* and to pay off his losses he indorses his negotiable note to *W*. *W* then sues *M* to recover the amount of the note. May *M* set up the fact that *W* acquired the instrument in an illegal transaction and thereby claim as a defense the *jus tertii* that legal title [27] is in a third person, *P?* In the New York case of *Hurley v. Union Trust Co. of Rochester*,[28] under these same facts, the court held that the title of the plaintiff was *defective* and he therefore could not sue on the instrument. The decision is not too clear as to what interest the plaintiff did have. An analogy was made between the plaintiff and a finder, the court saying: "Plaintiff's title would have been as sound and as complete if he had found the checks on the street, or if by some accident they had been transferred from the pocket of Dicks [the payee] to the wallet of plaintiff after they had been indorsed, or if they had been mailed to the plaintiff by mistake. . . ." [29] The court, in effect, was allowing the defendant to set up the *jus tertii* of legal title in a third person. Other jurisdictions, under similar circumstances, have refused to do this.[30]

An interesting problem arises if we extend the facts in the *Hurley* case. Assume that *W*, the winner in the gambling transaction, had further negotiated the instrument to a holder in due course. Here then is a situation in which a negotiable instrument, valid in its inception, has in the line of indorsements been illegally transferred and has subsequently come into the hands of a holder in due course. Would the N.I.L. protect the holder in due course and allow him to sue? The N.I.L. specifically states that a holder in due course takes free from prior defects in title.[31] The issue is therefore narrowed

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[24] N. Y. GENERAL BUSINESS LAW § 373.

[25] Sabine v. Paine, 223 N. Y. 401, 119 N. E. 849 (1918).

[26] N. Y. PENAL LAW § 993; Cunningham v. Gans, 79 Hun 434, 29 N. Y. Supp. 979 (1894); Larschen v. Lantzes, 115 Misc. 616, 189 N. Y. Supp. 137 (Sup. Ct. 1921). The plaintiff in the latter case was a holder in due course.

[27] Section 993 of the Penal Law makes the transfer of an instrument in payment of a gambling debt *void* as distinguished from voidable. Hence, of necessity, the loser must retain the legal title.

[28] 244 App. Div. 590, 280 N. Y. Supp. 474 (3d Dep't 1935); *accord*, Singer v. Union Table and Spring Co., 151 Misc. 909, 271 N. Y. Supp. 349 (N. Y. Munic. Ct. 1934).

[29] 244 App. Div. 590, 592, 280 N. Y. Supp. 474, 477 (3d Dep't 1935).

[30] Rumping v. Arkansas Nat. Bank of Hot Springs, 121 Ark. 202, 180 S. W. 749 (1915); Reynolds v. Gregg, 258 S. W. 1088 (Tex. 1924).

[31] See note 13 *supra*.

down to the question of whether the prior illegal transfer results merely in a defect in title or like a forgery, voids the instrument altogether. The case of *Bernstein v. Fuerth*,[32] under similar facts, held that payment to the holder in due course is a good defense to a subsequent suit by the payee loser.[33] The court said: ". . . the taint of illegality, if any, did not attach until after the check became a valid and subsisting obligation in the hands of the plaintiff, [the payee] and to hold that an act on the part of the payees can render void, in the hands of a holder in due course, a theretofore valid negotiable instrument duly negotiated would result in injustice and confusion in commerce unwarranted by the public policy involved." [34] The case cannot be considered as an authority, however, because there was not sufficient evidence to show that the illegal transaction took place within the state, a necessary requirement to come within the purview of our gambling statute. The statements made in the decision, though really *dicta*, probably present a correct view. The history of the law merchant and the present N.I.L. show a desire to aid negotiability by giving a holder in due course almost impregnable protection. When an exception arises the N.I.L. has clearly specified it.[35] Furthermore, the *Hurley* case, in comparing the gambler to a finder, leaves the inference that like a finder of bearer paper, he may negotiate to a holder in due course and such a holder will be protected. The statement in the *Hurley* case that the plaintiff could not lawfully negotiate the instrument takes nothing away from the argument. A finder of bearer paper may not lawfully negotiate the instrument, but still the courts protect a holder in due course who takes from the finder. The *Hurley* case also makes note of the fact that the plaintiff was not a holder in due course, but does not elaborate as to what the result would be if he was such a holder.[36] It is submitted that if a case came up today on all fours with the stated hypothetical, the *dicta* in the *Bernstein* case would represent the stand that New York would follow.[37]

Conclusion

As has been seen from the foregoing discussion, the New York view prohibits a defendant from setting up the *jus tertii* of equitable

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[32] 132 Misc. 343, 229 N. Y. Supp. 791 (N. Y. Munic. Ct. 1928).

[33] To the same effect, see Tindall v. Childress and May, 2 Stew. & P. 250 (Ala. 1832).

[34] 132 Misc. 343, 347, 229 N. Y. Supp. 791, 796 (N. Y. Munic. Ct. 1928).

[35] See note 21 *supra*.

[36] *Accord*, Singer v. Union Table and Spring Co., 151 Misc. 909, 271 N. Y. Supp. 349 (N. Y. Munic. Ct. 1934).

[37] For a contrary view, see Chapin v. Dake, 57 Ill. 295, 299 (1870), wherein the court denied recovery on the instrument by a holder in due course under such circumstances, saying, ". . . the indorsement was clearly void as between the parties to the transaction, and, we think, . . . the legal consequence must be the same of such an indorsement in the hands of a bona fide holder—that no more effect is to be given to it than a forged indorsement."

title in a third person. Notable exceptions occur when all the parties are before the court and also when the only purpose of setting up the *jus tertii* is to show that the plaintiff is not a holder in due course, thus letting in a personal defense. In the case of the defense of legal title in a third person the law is different. Here the defense is generally permitted except as against a holder in due course, and even there it is allowed when the instrument is forged. Under illegality of transfer the courts recognized the defense as against an ordinary holder, but the conclusion was reached that it would not be available against a holder in due course.

The Negotiable Instruments Law has not clearly stated its position in respect to the application of *jus tertii.* The reader, on analyzing its provisions, is confronted with the problem of contrary inferences. This obscurity in expression warrants clarification. A sweeping rule regarding the application of *jus tertii* should be enacted, and the specific exceptions engrafted, instead of making specific declarations limited in scope and leaving the sweeping rule to the ingenuity of the reader.[38]

[38] The Uniform Commercial Code does just that. § 3-306(d).