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Negotiable Instruments--Conditional Sale Contract--Finance Company Not a Holder in Due Course (Commercial Credit Corporation v. Orange County Machine Works et al., 34 Cal.2d 766 (1950))

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reached in the *Syracuse Savings Bank* case is no more than a logical extension of the protection so consistently afforded mortgagees by the New York courts. The decision is supported by a strong preponderance of authority elsewhere.[24]

NEGOTIABLE INSTRUMENTS — CONDITIONAL SALE CONTRACT — FINANCE COMPANY NOT A HOLDER IN DUE COURSE.—Defendant, contracting with a seller to purchase a mechanical press, executed both a conditional sale contract and a promissory note upon plaintiff-finance company's blank. The seller assigned the note and contract, which were separated by a perforated line, to the plaintiff. He then failed to deliver the press to the defendant. Plaintiff brought suit on the note upon defendant's refusal to pay. Defendant raised the personal defense of failure of consideration. *Held,* judgment for defendant. When a finance company actively participates in a conditional sale transaction from its inception by counseling and aiding the future vendor-payee, it cannot be regarded as a holder in due course of the note given in the transaction and the defense of failure of consideration may be properly maintained. *Commercial Credit Corporation v. Orange County Machine Works* et al., 34 Cal. 2d 766, 214 P. 2d 819 (1950).

The position of the assignee-finance company in consumer conditional sales contracts has long been the source of conflicting opinions between both financiers [1] and jurists.[2] These finance companies, who derive their profit from the discounting of notes, have, in effect, "the actual control and management of the credit and finance of sellers doing a conditional sale business." [3] Yet, they attempt to use the shield of a holder in due course [4] in order to gain the advan-

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[24] See note 21 *supra.*

[1] Adelson, *The Mechanics of the Instalment Credit Sales,* 2 LAW AND CONTEMP. PROB. 218 (1935).

[2] WHITNEY, OUTLINE OF THE LAW OF SALES § 30 (4th ed. 1947); Schwartz, *Rights of the Holder of a Combined Note and Security Contract,* New York Law Journal, Dec. 28, 1936, p. 2400, cols. 1-3; 53 HARV. L. REV. 1200 (1940).

[3] Buffalo Industrial Bank v. De Marzio, 162 Misc. 742, 744, 296 N. Y. Supp. 783, 785 (City Ct. 1937), *rev'd on other grounds,* 6 N. Y. S. 2d 568 (Sup. Ct. 1937).

[4] NEGOTIABLE INSTRUMENTS LAW § 52; N. Y. NEG. INST. LAW § 91: "A holder in due course is a holder who has taken the instrument under the following conditions: (1) that it is complete and regular upon its face; (2) that he became the holder of it before it was overdue, and without notice that it had been previously dishonored, if such was the fact; (3) that he took it in good faith and for value; (4) that at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it."

tages of the Law Merchant.[5] The buyer frequently is not in a position fully to protect himself from the various "mercantile loopholes" engendered. Consequently, many jurisdictions realizing the buyer's problem have remedied the advantage held by these finance companies. Some states have looked beyond the contract and implemented a sense of equitable justice to effect what has been called "household law." [6] In *Buffalo Industrial Bank v. DeMarzio,*[7] a bank, which financed the conditional sale of an oil-stove and held the buyer's note given in part payment, could not recover when the stove did not operate as stipulated by the seller's guaranty. The New York court said: "The finance company and the merchant seller are as a fact engaged in one business. . . . To pretend that they are separate and distinct enterprises is to draw the veil of fiction over the face of fact." [8] Statutes, too, have been passed in many states to balance the bargaining power of the buyer by requiring full disclosure of instalment agreements,[9] by outlawing the use of objectionable contract provisions [10] or by licensing and regulating both vendors and financing agencies.[11] Other courts, however, finding this imputation of control inconsistent with the Law Merchant, have been reluctant to limit "negotiability." [12] They have allowed finance companies, who have provided sellers with blanks, information, etc., and who are "specific assignees" of the contract, to recover on the note although attached to a conditional sale contract.[13] Since negotiability renders

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[5] Real defenses are available against holders in due course as well as against holders not in due course whereas personal defenses are available only as against holders not in due course. See BRITTON, ON BILLS AND NOTES § 125 (1943); BEUTEL'S BRANNAN NEGOTIABLE INSTRUMENTS LAW § 55 (7th ed. 1948).

[6] See note 3 *supra.*

[7] 162 Misc. 742, 296 N. Y. Supp. 783 (City Ct. 1937), *rev'd on other grounds,* 6 N. Y. S. 2d 568 (Sup. Ct. 1937); *accord,* C.I.T. Corporation v. Joffe, 157 Misc. 225, 283 N. Y. Supp. 881 (N. Y. Munic. Ct. 1935), *rev'd on other grounds,* 162 Misc. 328, 293 N. Y. Supp. 659 (Sup. Ct. 1937); Palmer v. Associates Discount Corporation, 124 F. 2d 225 (D. C. Cir. 1941) (as holder was named on the face of the note as the dealer's agent to receive payment, it was reasonable to infer that he was in possession of the note and demanded payment in that capacity); Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S. W. 2d 260 (1940); C.I.T. Corporation v. Emmons, 197 So. 662 (La. 1940).

[8] *Id.* at 744, 296 N. Y. Supp. at 785.

[9] N. Y. PERS. PROP. LAW § 64a.

[10] MD. ANN. CODE GEN. LAWS Art. 83, §§ 116-52 (Flack Supp. 1947).

[11] IND. ANN. STAT. §§ 58-901ff (Burns 1943).

[12] Negotiability as herein discussed is not determinable by the present holder of the instrument but rather by its adherence to the Negotiable Instrument Law's requirements. A note, if negotiable at its inception, continues as such throughout its journey unless restrictively indorsed; it is only the transferee's or indorsee's position that is capable of change. WHITNEY, BILLS AND NOTES § 7 (1948).

[13] Mayer v. American Finance Corp., 172 Okla. 419, 45 P. 2d 497 (1935); Security Finance Co. v. Schoenig, 292 S. W. 556 (Tex. 1927) (evidence in support of claim that plaintiff was owned and controlled by payee of note held insufficient to show plaintiff was not a good faith purchaser for value).

consumer sale contracts more appealing, finance companies, in those states which impute knowledge to the company, have incorporated within their sales blanks "waiver clauses" which will bar the buyer from setting up defenses against the company. These clauses have been held valid.[14]

This obvious clash of interests apparently has not been resolved in the New Commercial Code,[15] for under this Code the ruling law of the individual state will be the norm in any specific action. Fear of limiting negotiability, fear of setting up definite statutory standards which will destroy the desired flexibility, and fear of unwieldy delimiting phraseology have been advanced as reasons for the refusal to uniformize this controversial subject.[16]

It would seem that present financial practices, where seller and financier work "hand in glove," in itself should prevent the specific assignee from being a holder in due course, but even further restraint is needed in the way of stronger safeguards to rectify the conditions and practices which lead to these advantages. The right of finance companies to take an unfair advantage of the Negotiable Instruments Law is to carry the rule to an absurdity. This was certainly not the law under the rules of the Law Merchant and should be quickly remedied.

SALES — FOREIGN MATTER IN FOOD — SECTION 200 OF THE AGRICULTURE AND MARKETS LAW.—The plaintiff was injured by a piece of wire imbedded in the pie purchased in a restaurant. In an action against the baker for negligence the plaintiff showed that the wire was in the pie when it was delivered by the baker. *Held,* judgment for the plaintiff. Although the plaintiff did not plead any statute, the court held that these facts constituted a breach of Section 200 of the Agriculture and Markets Law.[1] *Alphin v. La Salle Diners, Inc.* et al., 197 Misc. 415 (N. Y. City Court 1950).

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[14] National City Bank v. Prospect Syndicate, 170 Misc. 611, 10 N. Y. S. 2d 759 (N. Y. Munic. Ct. 1939).

[15] AMERICAN LAW INSTITUTE AND NAT'L CONF. OF COM'RS ON UNIFORM STATE LAWS, THE CODE OF COMMERCIAL LAW Art. III (proposed final draft, 1950).

[16] For an interesting discussion on the consumer conditional sale contract problem and The Commercial Code, see Note, 57 YALE L. J. 1414 (1948).

[1] "Food shall be deemed to be adulterated, 1. If it bears or contains any poisonous or deleterious substance which may render it injurious to health, 2. If it bears or contains any added poisonous or deleterious substance which is unsafe within the meaning of Section 202. . . ." N. Y. Agriculture and Markets Law § 202 provides that any poisonous or deleterious substance added to food may be deemed unsafe within the meaning of Section 200 except where it is required by the needs of good manufacturing process.