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Article 10

Negotiability of Corporate Bonds

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spouses will live together; and this because of an ante-nuptial fraud through which consent to the marriage was procured.

The prevailing opinion in the *Shonfeld* case,[34] once and for all time, repudiates the "to the very essence of the contract" doctrine [35] as enunciated in the *Fiske* case. The Court approves the criterion established in the *Di Lorenzo* case [36] for the determining of the materiality of the fraud, and unequivocally accepts the doctrine in that case to the effect that marriage is a civil contract and voidable in the absence of free consent.[37]

When Judge Crouch, speaking for the majority, says: "* * * no public policy demands that prudent consideration of ability to fulfill the duty of support shall not have a legitimate place in the determination by a party whether or not to marry," [38] we hear the authentic voice of judicial realism.

JACOB SALZMAN.

NEGOTIABILITY OF CORPORATE BONDS.

There is a sharp diversity of opinion concerning the negotiability of corporate bonds or notes issued under a collateral trust deed or agreement, which bonds or notes contain on their face a reference clause referring the holder to said trust deed or agreement for a statement concerning the security posted, or the rights and liabilities of the holder of said bonds or notes, or both.

The arguments pro and con center upon two theories: (1) notice, (2) consistency. The federal rule is, that such a clause gives a purchaser notice, actual or implied, of all the terms of the trust deed or agreement, and a provision in such deed limiting or regulating the method of enforcing the liability of the obligor on said bond or note is not inconsistent with the promise to pay therein expressed. The New York rule is that the question of notice is one dependent upon the wording of said clause and if a clause in a trust deed affects in any way the promise to pay expressed in the bond, such is inconsistent with said promise and must be disregarded.

In the *New York Law Journal,* Feb. 8, 1933, Goldstein, *J.*, directed a verdict in favor of the plaintiff in an action based on a bond of the defendant issued under and pursuant to a trust agree-

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[34] *Supra* note 2.

[35] *Ibid.* at 479, N. E. at 61: "* * * the fraud need not necessarily concern what is commonly called the essentials of the marriage relation: the rights and duties connected with cohabitation and consortium attached by law to the marital status."

[36] *Ibid.*

[37] *Ibid.*

[38] *Ibid.* at 482, N. E. at 62.

ment, which bond, on its face contained a clause, *"to which indenture reference is hereby made for a statement of the rights of the holders of said bond."*[1] The argument of the Court is that the bond is designated a negotiable instrument, contains all the essentials thereof as prescribed by statute, and that the reference clause was insufficient to give notice to a purchaser of other possible rights and obligations not evidenced on the bond itself, and further, that if it did, such was inconsistent with the primary obligation represented by the bond. It is submitted that the arguments are not sound as applied to the law or facts in this case, and that the authorities cited in support, are not in point.

In the case of *Berman* v. *Consolidated Nevada-Utah Corp.*[2] the reference clause was worded *"reference to which indenture is hereby made for a statement of the nature and extent of the security, the rights of the holder of said bonds, and terms and conditions upon which the bonds are issued."* It is only essential to compare the two reference clauses to see that they are not, as Goldstein, *J.*, said, "almost identical." The Court held in the *Berman* case,[3] (1) "the bond and trust deed must be construed together," thereby impliedly holding that there was an incorporation by reference, and (2) "that the provisions of the trust deed are inconsistent with the unconditional promise to pay, and should be strictly construed against the drawer of the deed and therefore should be disregarded." It is with regard to the second holding that the major question arises herein.

Also cited with much approval is the case of *Rothschild* v. *The Rio Grande.*[4] That case is also not in point for the action there was based upon coupon certificates which on their face were absolute and unconditional promises to pay the indebtedness represented thereon. Everything said by the Court in that case, re: inconsistency of the clauses, was pure dicta which concerned itself with a protective mantle to be thrown over the (supposedly) [5] unwary, gullible, foolish, innocent purchaser of corporate securities. Further, the Court therein, as well as in the instant case accepts as true that which is so because the Court thinks it so. In short, the Court holds that "ambiguous phrases must be strictly construed against the drawer, and since the reference clause itself did not absolutely state all the terms and conditions, that it was therefore ambiguous, and so any clauses in the trust agreement inconsistent with an unconditional obligation to pay should be disregarded."

But is the clause in the trust deed limiting or qualifying the right to sue on a bond or note ambiguous and/or inconsistent with

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[1] Lubin v. Pressed Steel Car Co. (1932).

[2] 132 Misc. 464, 230 N. Y. Supp. 421 (1928).

[3] *Ibid.*

[4] 84 Hun 103, 32 N. Y. Supp. 37, 164 N. W. 594 (1st Dept. 1895).

[5] Writers Interlineation.

a promise to pay? The federal rule says "no," [6] the New York rule seems to say "yes." [7]

The first question to be answered is, "are bonds such as these negotiable?" If they are, no defence is available to the obligor;[8] if not, all the terms of the trust deed are incorporated in, and binding upon, the holders of the bonds and available as a defense to the obligor. The writer upholds the latter contention.

It should be noted moreover, that in a number of cases, the New York courts have been forced to disregard the innocent purchaser or inconsistent clause theory because in those cases, the chose-in-action expressly stated on its face *"subject to the terms of the * * * agreement."* [9] This seems to imply that the courts of this state require such express language on the bond or note before they will consider the two instruments together, and yet in a recent case,[10] the Court of Appeals has repudiated this rule and substituted one of construction of the entire bond or note.

The main argument in all cases centers about the definition of an *unconditional* promise to pay. That is a term used to indicate that the obligor absolutely promises to pay without any ifs, or conditions qualifying or limiting the promise to pay.

The intentions of a party issuing an instrument notwithstanding, the negotiability of an instrument is determined by the terms of the instrument itself, read in its entirety. If any qualification, reference, or condition exists and is present in the instrument, concerning the promise to pay, negotiability is destroyed.[11]

As was enunciated in the case of *Enoch* v. *Brandon,*[12] "we must consider the instrument as a whole, not wresting any one

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[6] McClure v. Township of Oxford, 94 U. S. 429 (1876); Kimber v. Gunnel Gold Mining Co., 126 Fed. 137 (C. C. A. 6th, 1903); Nat. Salt Co. v. Ingraham, 122 Fed. 40 (C. C. A. 2d, 1903); Babbit v. Read, 236 Fed. 42 (C. C. A. 2d, 1916); People's Bank v. Porter, 58 Cal. App. 41, 208 Pac. 200 (1922); Croswaite v. Moline Plow Co., 298 Fed. 466 (D. C. S. D. N. Y. 1924); Allan v. Moline Plow Co., 14 F. (2d) 912 (C. C. A. 8th, 1926); Ledgerwood v. Hale & Kilburn Corp., 47 F. (2d) 318 (D. C. S. D. N. Y. 1930).

[7] Enoch v. Brandon, 249 N. Y. 263, 164 N. E. 45 (1928); *supra* notes 1 and 2.

[8] NEGOTIABLE INSTRUMENTS LAW (N. Y.) §91.

[9] McClelland v. Norfolk S. R. R. Co., 110 N. Y. 469, 18 N. E. 237 (1888); Batchelder v. Council Grove Water Co., 131 N. Y. 42, 29 N. E. 801 (1892); Watson v. Chicago, R. I. & P. Ry. Co., 169 App. Div. 663, 155 N. Y. Supp. 808 (1st Dept. 1915); Chatham-Phoenix Nat. Bank & Trust Co. v. Lewis, 142 Misc. 585, 255 N. Y. Supp. 73 (1932); Heimar v. Murphy, 143 Misc. 81, 256 N. Y. Supp. 20 (1932); Graglia v. Chanbrook Realty Corp., 143 Misc. 450, 256 N. Y. Supp. 666 (1932); Freilich v. 79 Madison Ave. Corp., 144 Misc. 312, 258 N. Y. Supp. 685 (1932).

[10] *Supra* note 7.

[11] National Bank of Watervliet v. Martin, 203 App. Div. 390, 196 N. Y. Supp. 714, *aff'd,* 235 N. Y. 611, 139 N. E. 755 (1923); Old Colony Trust Co. v. Stumpel, 247 N. Y. 538, 161 N. E. 173 (1928); Equitable Trust Co. of N. Y. v. Howe, 72 Misc. 46, 129 N. Y. Supp. 112 (1911); People v. Gould, 347 Ill. 298, 179 N. E. 848 (1932); *supra* note 6.

[12] *Supra* note 7.

phrase from its context and concentrating our attention upon it alone." And again, in the same case "each instrument must be interpreted by itself, for the different arrangement of words, clauses, sentences, etc. * * * all may affect the meaning and intent of the promise to pay." The court may not, it seems, take any one part of the note or bond such as "I promise to pay," determine such to be an unconditional promise and therefore disregard anything else thereafter that may affect a promise to pay upon the ground that it is inconsistent.

The dicta in the *Rothschild* case,[13] as well as the discussion in the *Lubin* case,[13a] as to the question of notice upon which the incorporation by reference is based, to the effect that the innocent purchaser of a bond or note cannot know of the limitations or restrictions imposed by a trust agreement governing the issuance of said bond or note is absolutely fallacious. The reference clause gives the purchaser, in plain language, notice of said trust agreement and he can demand a copy thereof. But, in truth, the average investor never sees the bond or note until after purchase. He gives an order to his broker who purchases for him. After purchase, he seldom does more than verify the face obligor of the bond or note. He buys such on market reports, tips, or hunches concerning financial returns of said investment. If he ever did take the trouble to read the face of the bond or note, he could not miss the reference clause and his natural query would be, "what does it contain?" But even then, rarely would he bother to request a copy thereof and still more rare, read it. As a matter of fact, he is content to invest—gamble would be a more appropriate description of his act—in the hope that everything is, or will be, all right, and if and when events turn out otherwise than as he hoped, he dashes into court seeking aid under the plea of an innocent purchaser without notice against the powerful (?) corporate oppressor, and the courts in this state seem to have been inclined to listen to his plea.

The Court of Appeals in the case of *Old Colony Trust Co.* v. *Stumpel*[14] has said "if in the bond or note anything appears requiring reference to another document to determine whether or not a *seeming unconditional promise* to pay is qualified, modified, or subject to other terms, then the promise to pay is no longer unconditional, regardless of what the other documents may contain or provide." In all these bonds and notes cases there are such similar references, thus affecting the negotiability and making them non-negotiable, with all defences available to the obligor as would have existed between the immediate parties.

As to the holding of the Court that the provisions of the trust agreement qualifying, limiting, or conditioning the manner or method of enforcing the obligation as evidenced by the bond or note, are

[13] *Supra* note 4.

[13a] *Supra* note 1.

[14] *Supra* note 11.

inconsistent with the unconditional promise to pay and so should be disregarded on the ground of strict construction applied against the drawer of the agreement, the writer reiterates that the term *unconditional* is merely descriptive of the entire bond or note, and if it is possible to show that something outside of the instrument may, because of the reference on its face, qualify, limit or condition the promise to pay, as in this case, then it is not unconditional in nature within the meaning of the statute. There is nothing inconsistent in a provision in a trust agreement which merely regulates the manner or method of enforcing the obligation as expressed in the bond or note with its promise to pay, for the promise to pay is present and unaffected in so far as the liability of the obligor is concerned. The only thing affected or governed is the manner or method of enforcing payment, and such has been held not to be inconsistent with a promise to pay in a bond or note.[15] It was said by the Court in the case of *Allen* v. *Moline Plow Co.*,[16] "these provisions (referring to manner of enforcing obligation) were not written into the trust agreement for the sole benefit of the defendant but rather for the benefit of all the noteholders." And again in the same case, "the purpose and intent of the terms of the trust agreement was to insure a united action of a representative body to protect the interests of the whole group of noteholders as well as the defendant so that the latter could protect the interests of all its creditors. It was so aimed as to prevent any individual creditor from pursuing a separate, individual remedy and so possibly jeopardize the financial structure and credit of the defendant as well as the security of the creditors as a whole. Manifestly it must be deemed that the plaintiff had notice of all this and to have assented thereto, and it would be inequitable to now permit him to act otherwise to the undoubted harm and injury of all the creditors of the same class as the plaintiff, as well as the defendant."

To sum up, a bond or note, having a reference on its face to another instrument for a statement of the nature and extent of the rights of the parties thereto, is a non-negotiable instrument, since it does not express an unconditional promise to pay, for further rights and obligations contained in the collateral instrument are incorporated by the reference into the bond or note which *may* affect the promise to pay. And a provision in such a collateral agreement regulating or limiting the method of enforcing the liability of the obligor on the bond is not inconsistent with the promise to pay because it is still present and unaffected, nor against public policy.[17]

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[15] Croswaite v. Moline Plow Co., Allan v. Moline Plow Co., Ledgerwood v. Hale-Kilburn Corp., *supra* note 6.

[16] *Ibid.*

[17] *Ibid.*