

## The Payee as a Holder in Due Course in New York

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## NOTES AND COMMENT

Editor—PHILIP ADELMAN

### THE PAYEE AS A HOLDER IN DUE COURSE IN NEW YORK.

Whether the payee may be a holder in due course under the Uniform Negotiable Instruments Law is a question upon which the courts are in serious conflict. In eleven states the affirmative view prevails.<sup>1</sup> Many of the states which hold this view have quoted with approval the reasoning in the case of *Boston Steel and Iron Co. v. Steur*.<sup>2</sup> In that case a woman delivered to her husband a check made payable to a certain creditor of hers with instructions to pay her debt with it. Instead, the husband handed the check to the creditor as a payment upon a debt of his own, who accepted it as such, in good faith. *Held*, the creditor was a holder in due course.

The negative view is followed in five states.<sup>3</sup> Other states seem to have side-stepped the issue.<sup>4</sup>

In *Hathaway v. County of Delaware*,<sup>5</sup> our court of last resort took the negative view in principle, but no reference was made to the Negotiable Instruments Law, and the decision may have rested on its special facts, since the court was of the opinion that the payee was put on inquiry. Those writers who maintained that a payee may be a holder in due course explain the *Hathaway* case by calling attention to its date, 1906. The defendant claimed that the consideration for the negotiable instrument was the cancellation of a pre-existing debt.<sup>6</sup>

As to antecedent debt, Judge Story said that receiving negotiable paper in payment of or as security for a pre-existing debt is receiving it for a valuable consideration. "It is for the benefit and convenience of the commercial world," he says, "to give as wide an extension as practicable to the credit and circulation of negotiable paper, that it may pass not only as security for new purchases and advances made upon the transfer thereof, but also in payment of and as security for pre-existing debts."<sup>7</sup> The opposite doctrine would strike a fatal blow at all discounts of negotiable securities for pre-existing debts.

In New York the case handed down took issue with the doctrine of Judge Story. The reasoning in these cases was based not so much

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<sup>1</sup> Alabama, Connecticut, Illinois, Massachusetts, Montana, New Jersey, Oregon, Pennsylvania, Tennessee, Texas and Vermont.

<sup>2</sup> 183 Mass. 140, 66 N. E. 646 (1903).

<sup>3</sup> Iowa, Kentucky, Missouri, Oklahoma and South Dakota.

<sup>4</sup> See BRANNAN, ANNOTATED NEGOTIABLE INSTRUMENTS LAW (4th ed. 1926) §52 for decisions upholding the negative view.

<sup>5</sup> 185 N. Y. 368, 78 N. E. 153 (1906).

<sup>6</sup> At the time a conflict raged in the first and second departments of the Appellate Divisions as to what constituted a valuable consideration under the NEGOTIABLE INSTRUMENTS LAW.

<sup>7</sup> NORTON, BILLS AND NOTES (4th ed. 1914) pp. 421-423.

upon the practical doctrines of commercial convenience as upon the strict logic of the law itself. The New York doctrine held that the position of the bona fide holder rests its foundation upon the equitable doctrine that a purchaser who holds the legal title to property merely as security for or for payment of a pre-existing debt without parting with anything of value is not entitled to hold as against the prior equitable holder.<sup>8</sup>

It was not until the year 1919 that the Court of Appeals, in its decision in the case of *Kelso v. Ellis*,<sup>9</sup> brought our state into harmony with the law of the United States Supreme Court, by holding that the rule enunciated by Story was the true doctrine. Therefore, the *Hathaway*<sup>10</sup> case is of no use to us.

The inferior New York courts have left the question open. In *Brown v. Brown*,<sup>11</sup> it was held that the payee was a holder in due course and that consequently an agreement between the maker and the third party relative to payment did not bind the payee. In *Empire Trust Co. v. Manhattan Co.*,<sup>12</sup> the court stated that a payee may be a holder in due course but held that on the facts presented the payee was not such a holder. Briefly, *A* drew a check on defendant bank payable to plaintiff, gave it to a messenger to have it certified and give to plaintiff in payment of revenue stamps. The defendant certified the check, *B* stole it, and passing as *A's* messenger delivered it to plaintiff, who gave full value for it.

Plaintiff sued defendant and it was held that even assuming plaintiff acted in good faith, he was not a holder in due course and could not recover. This decision was affirmed in the Appellate Division without opinion.<sup>13</sup>

Professor Brannan, who holds that the payee may be a holder in due course, regrets that the Appellate Division gave no opinion in this case and remarks that when appellate courts affirm judgments without an opinion and without even adopting the opinion of the lower court, one is led to suspect the court had difficulty in finding reasons for its affirmance. Another authority approves of the decision because the thief presented himself to the payee as an agent and not as the remitter, thereby putting the payee on inquiry as to the existence of the agency<sup>14</sup>—but this reasoning does not seem to have been in the mind of the court.

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<sup>8</sup> *Coddington v. Bay*, 20 John 637 (N. Y. 1822); *Sutherland v. Mead*, 80 App. Div. 103, 80 N. Y. Supp. 504 (1st Dept. 1903); *cf. Young v. Guy*, 87 N. Y. 457 (1882).

<sup>9</sup> 224 N. Y. 528, 121 N. E. 364 (1919).

<sup>10</sup> *Supra* note 5.

<sup>11</sup> 91 Misc. 220, 154 N. Y. Supp. 1098 (1915).

<sup>12</sup> 97 Misc. 694, 162 N. Y. Supp. 629 (1916).

<sup>13</sup> 180 App. Div. 891, 167 N. Y. Supp. 1098 (1st Dept. 1917); see criticism of decision in Note (1917) 30 HARV. L. REV. 515.

<sup>14</sup> Moore, *The Right of the Remitter of a Bill or a Note* (1920) 20 CALIF. L. REV. 749.

In a more recent case<sup>15</sup> the Appellate Division stated that it was error for the trial court to charge that a payee may be a holder in due course. But the charge was dictum, as the case was decided on principles of suretyship.

The above cases will suffice to show that our courts have not spoken with certainty on the question.

A brief discussion as to what elements constitute one a holder in due course is now in point. Section 52 of the Uniform Negotiable Instruments Law (§91 of the N. Y. Neg. Ins. Law) states 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 \* \* \*; (3) That he took it in good faith and for value, and (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. Brannan argues that the stumbling block is the term *negotiated* in subdivision four. He asks, "Is negotiation limited to transfer by indorsement?" He maintains that at common law a payee may be a holder in due course and attempts to construe the Uniform Negotiable Instruments Law so that the same result will be reached. His method may be set forth as follows: By §30 of the Uniform Negotiable Instruments Law (§60 of the N. Y. Neg. Ins. Law) an instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the legal holder thereof. It is only necessary to transfer the instrument so as to constitute the transferee a *Holder*; as a payee, who is in possession is by §191 of the Uniform Negotiable Instruments Law (§2 of the N. Y. Neg. Ins. Law) a holder, it is clear that a maker or drawer, for instance, or a person intrusted with the instrument, though not himself a holder, negotiates the instrument when he transfers it to the payee. The last sentence of §30 (§60 of the N. Y. Neg. Ins. Law), which states, "If payable to order it is negotiated by the endorsement of the holder completed by delivery," must be construed to refer to negotiation after the instrument has come into the hands of the payee or other holder (endorser). Reading the definition of *Holder* in §191 (§2 of the N. Y. Neg. Ins. Law) into the paragraph it will read, "If payable to order it is negotiated by the endorsement of the *payee* or endorsee who is in possession."

Thus, says Brannan, under the two sections, 30, 191 (60, 2, of the N. Y. Neg. Ins. Law), a negotiable instrument payable to the order of a named payee is negotiated when the physical possession of it is handed for value to a person named as payee. One effect of the last sentence of §30 (§60 of the N. Y. Neg. Ins. Law) is to describe the method by which the person who first becomes the holder

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<sup>15</sup> Cohen v. Rossmare, 225 App. Div. 300, 233 N. Y. Supp. 196 (1st Dept. 1929).

may pass it. It does not comprehend all the ways by which an instrument may be negotiated.<sup>16</sup>

Before examining the view of Brannan, we shall briefly look at the statements of two other authorities who agree that the payee may be a holder in due course. Professor Hening, after reaching the conclusion that the conflict arises in distinguishing between proximity and privity of parties, says, "Under the law merchant there was no incongruity in permitting a payee to recover against the maker or acceptor when the payee was an innocent party deceived by the agent of the maker or acceptor. Mere proximity of the names on commercial paper is not conclusive as to privity, no more than the apparent remoteness on the face of the paper is conclusive as to the absence of privity."<sup>17</sup>

Norton, in his work on bills and notes, says, "Negotiability as a theory only aims to protect innocent parties who have taken the instrument in ignorance of the existence of defects, affecting some contract embodied in the instrument before such innocent party takes it. A remote party is one who knows nothing of the facts of defense which have arisen between immediate parties. \* \* \* He is to be protected in paying money or in giving value for the instrument, from the wrong other parties have committed. The wrong which has tainted their contract does not vitiate his. He stands in the position of one fortified by doctrines of equity who will be protected \* \* \* because loss was not occasioned by his act, but rather by that of some prior party of whom he knows nothing, and it being determined whether parties are immediate or remote it then becomes clear whether the general rules of law applicable to contracts or the peculiar rules applicable to negotiable instruments apply."<sup>18</sup>

These authorities argue that if a payee cannot be a holder in due course, the universal mercantile custom and the overwhelming weight of authority have been upset by the Negotiable Instruments Law. As Moore puts it, "It would indeed be regrettable if the courts of the greatest commercial state have taken a position so contrary to the common law."<sup>19</sup>

As most of these writers have continually alluded to the rule at common law we will now glance at the common law rule in New York.

A search of the cases reveal that the common law rule was stated in *Nelson v. Cowing*,<sup>20</sup> in which case the payee of a negotiable note was allowed to recover from the maker on condition he prove he took the note before it matured, and paid value for it; but the court

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<sup>16</sup> BRANNAN, ANNOTATED NEGOTIABLE INSTRUMENTS LAW (4th ed. 1926) §§14, 18, 52.

<sup>17</sup> Hening, *The Uniform Negotiable Instruments Law* (1911) 59 U. OF PA. L. REV. 471, 480.

<sup>18</sup> NORTON, BILLS AND NOTES (4th ed. 1914) pp. 258, 259.

<sup>19</sup> *Supra* note 14.

<sup>20</sup> 6 Hill 336 (N. Y. 1844).

refused to indulge in a presumption of *bona fides* in favor of the payee as it would have done in the case of an indorsee.

The decision shows that at common law the payee recovered on grounds of estoppel. It is certainly illogical to say that the payee is a holder in due course for the purpose of cutting off defenses good as against other and such holders, but holding him not to be a holder in due course within the provisions relating to burden of proof. If, as at common law, recovery by the payee is based on estoppel, that must still be the rule by the express language of §7 of the Negotiable Instruments Law, which is as follows: "In any case not provided for \* \* \* the rules of the law merchant shall govern."

As Brannan's construction of the Negotiable Instruments Law is in derogation of the law merchant, it cannot be accepted.<sup>21</sup>

Without doubt, an innocent payee of a negotiable instrument may recover under some circumstances, but a logical and strict construction of the Negotiable Instruments Law supports the conclusion that the payee of a negotiable instrument cannot be a holder in due course within the meaning of that phrase as used in the act.

If necessary, it could be shown that in practically every case where a payee has been held to be a holder in due course he would have been able to recover on the basis of an estoppel even if the instrument were non-negotiable. Thus, in the Massachusetts case of *Boston Steel and Iron Co. v. Steur*,<sup>22</sup> the payee could have been protected without holding him to be a holder in due course. In that case it will be recalled that the husband, who was directed to deliver a check, diverted it, and the payee might have recovered on the well-known principle of agency applicable to all types of contracts; namely, where an agent is clothed with apparent authority to do an act he may bind the principal within the limits of that authority whatever his private instructions may have been. Again, if *A* hands an instrument to *B* to be filled out, such instrument carries on its face implied authority to fill up the blanks, and to innocent third parties, the person to whom it was intrusted must be deemed the agent of the party who committed such instrument to his custody; or in other words, it is the act of the principal and he is bound by it.<sup>23</sup>

Hence, at common law, general common law principles operated to protect the payee of an instrument under certain conditions. The courts which hold the payee to be a holder in due course contend that a delivery, by a person who has procured the instrument, to the payee, is a negotiation, but this is erroneous since §191 of the Uni-

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<sup>21</sup> Brannan himself says that he has construed the statute to make it conform with the common law rule, but he is in error, as the rule at common law in New York is not as he sets it forth.

<sup>22</sup> *Supra* note 2.

<sup>23</sup> See *Liberty Trust Co. v. Tilton*, 217 Mass. 452, 105 N. E. 605 (1914), where on the facts as presented in the text, payee was held to be a holder in due course in order to protect him. But it is submitted that the true reason is estoppel and the payee of a simple contract would be similarly protected.

form Law (§2 of the N. Y. Neg. Ins. Law) defines the first delivery of the instrument as the "issuance thereof."

The bona fide holder of the law merchant, now the holder in due course, is accorded special rights, but such parties must be transferees (indorsees). When the payee is the holder he is protected by the general principles of law applicable to all contracts.

Although the payee might recover because of an estoppel, the question is not wholly verbal, as was said in a leading case,<sup>24</sup> because if there is a material alteration, the payee, not being deemed a holder in due course, could not recover even on the original tenor as that was the law prior to the passage of the uniform law.<sup>25</sup>

It appears, then, that a payee of an instrument is not to be deemed a holder in due course, and when he comes into court he must produce evidence sufficient to show that the party sued is to be estopped from setting up personal defenses. If the payee is able to sustain his burden he recovers as a matter of substantive law.

JULIUS NOVEMBER.

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#### ACCORD AND SATISFACTION—AVAILABILITY AS A DEFENSE.

Blackstone, in his treatise on the redress of private wrongs, enumerates two remedies which arise from the joint actions of the parties: Arbitration, and Accord and Satisfaction. He says of the latter "Accord is a satisfaction agreed upon between the party injuring and the party injured; which when performed is a bar of all actions upon this account."<sup>1</sup> The court has pointed out that in order to establish this defense there must be present a lawful subject matter, a sufficient consideration and *aggregatio mentis* or meeting of the minds.<sup>2</sup>

These elements, applicable to the determination of the validity of an accord and satisfaction, are similar to those necessary to support an ordinary contract. There exists an important distinction, however, where the accord is merely executory, for the recognition of bilateral contracts has not affected the established principle<sup>3</sup> that to become binding as a satisfaction the accord must be wholly executed.<sup>4</sup> The reason given in support of this holding was expressed

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<sup>24</sup> Snyder v. McEwen, 148 Tenn. 423, 256 S. W. 434 (1923).

<sup>25</sup> Likewise, if the maker was forced to execute the instrument by duress, he would have a good defense as there is nothing in the act of the maker to give rise to an estoppel. For an analysis of the common law rule, and the cases setting forth the rule, see 32 A. L. R. 289 (1924).

<sup>1</sup> 3 Bl. Comm. 15, quoted in Kromer v. Heim, 75 N. Y. 574, 576 (1879). For other definitions see 1 Cyc. 307 and cases there cited.

<sup>2</sup> Fuller v. Kemp, 138 N. Y. 231, 236, 33 N. E. 1034 (1893).

<sup>3</sup> 3 WILLISTON, CONTRACTS (1920 ed.) §1839.

<sup>4</sup> Reilly v. Barrett, 221 N. Y. 170, 115 N. E. 453 (1917); Moers v. Moers, 229 N. Y. 294, 128 N. E. 202 (1920); Kromer v. Heim, *supra* note 1 at 575.