FINANCE COMPANIES AS HOLDERS IN DUE COURSE OF CONSUMER PAPER

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Few legal principles are better developed or better known than the one that bona fide purchasers for value of negotiable instruments that are properly negotiated to them—in other words, holders in due course—take the instruments free of defenses that might be available between the original parties. Not only is the rule well known, but it is easy to come within it. Few seem so aware of this as finance companies. Nearly every sale they finance—and the total amount of money involved runs to billions[1]—involves a negotiable instrument, and the instrument is usually handled in such a way that the finance company has every reason to suppose that it has become, as it intended, a holder in due course. Yet there are a significant number of cases (though nothing approaching a majority) that indicate that these efforts are in vain, and that a finance company that purchases a negotiable promissory note from, say, an automobile dealer in the usual manner of financing a consumer purchase, is not a holder in due course of the instrument even though there is no suggestion of actual bad faith on its part. It is the purpose here to examine the cases in this area, both those that give the finance company the status of a holder in due course, and those that do not.[2]

First, however, it seems advisable to outline the normal fact situa-

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1. In December, 1957, there was $16,681,000,000 outstanding in automobile installment loans, and $11,621,000,000 in installment credit arising out of sales of other consumer goods. 44 Fed. Res. Bull. 182 (1958).

2. The matter has been considered by several commentators. The most exhaustive treatment is contained in an annotation entitled "Transferee of commercial paper given by purchaser of chattel and secured by conditional sale, retention of title, or chattel mortgage, as subject to defenses which chattel purchaser could assert against seller" in 44 A.L.R.2d 8 (1955). The great bulk of the relevant cases are contained in this annotation. It should be pointed out, however, that the annotation considers a great many problems that arise in the connection with the assignment of notes secured by chattel security devices which are not peculiar to finance companies—or, for that matter, that are not peculiar to secured notes, but are common to transfers of a negotiable instrument. There are such problems as taking the instrument after maturity, id. at 101-04, the effect of a signature of a maker obtained by fraud, id. at 42-43, etc. See also 34 N.C.L. Rev. 496 (1956); Note, Consumer Sales Financing: Placing the Risk for Defective Goods, 102 U. Pa. L. Rev. 782 (1954); Note, Finance Company as a Holder in Due Course, 28 Notre Dame Law. 251 (1953).

tion that underlies the cases.[3] It is a commonplace that a tremendous number of the sales of goods to consumers are not made for cash but on credit.[4] The types of credit devices that can be, and are, used, are legion. In connection with the more expensive items such as automobiles, however, the usual method is for the purchaser (buyer) to pay a certain percentage of the purchase price in cash, and to sign a note to the order of the seller for the balance.[5] Nowadays this note usually requires repayment in installments that amortize the remaining principal due as well as provide for interest (or "carrying" or "service charge" as it is usually called in deference to the usury statutes). Along with the note, the buyer will sign some sort of chattel security device such as a chattel mortgage, conditional sales contract, or bailment lease, which gives the payee of the note a lien (in fact, whatever the theoretical nature of the interest may be) on the item sold. The buyer gets possession of the chattel; the note and security device are then assigned to a financer. The financer may of course be a bank engaged in general banking activities (or, for that matter anyone). But the financer is at least as, if not more likely, to be a finance com-

3. The basic sources for this information are: Plummer & Young, Sales Finance Companies and Their Credit Practices 105-08 (1940); Seidman, Finance Companies and Factors 126-38 (Rev. ed. 1956) (hereafter Seidman); Consumer Credit Department, American Bankers Association, Home Appliance Financing 5-33, passim (1945); Phelps, Instalment Sales Financing: Its Service to the Dealer 21-37, 52-96 (1953).

4. The total amount of consumer credit outstanding in December 1957 was $44,798,000,000. 44 Fed. Res. Bull. 180 (1958).

5. Mr. Seidman states that the practice nowadays among finance companies is not to use negotiable notes in consumer installment sales. Hence, there would be no question of the finance company being a holder in due course. Seidman 134. Mr. Seidman, as President of the National Commercial Finance Conference, Inc., is certainly in a position to know. However, everything else that I have been able to find indicates that negotiable instruments are used. Thus, the note forms recommended by the American Bankers Association are negotiable. Consumer Credit Department, American Bankers Association, Home Appliance Financing 23 (1945). See also the conditional sales form of The Pennsylvania Company in Honnold, Cases on Sales and Sales Financing, 416-19 (1954). See also G.M.A.C. v. Daigle, 225 La. 123, 72 So. 2d 319 (1954) (chattel mortgage and negotiable note); Associates' Discount Corp. v. Goetzinger, 245 Iowa 326, 62 N.W.2d 191 (1954) (conditional sales contract and an apparently negotiable note); Commercial Credit Corp. v. Biagi, 11 Ill. App. 2d 80, 136 N.E.2d 580 (1956) (conditional sales contract and note). These are recent cases. The finance companies were large concerns. The finance companies furnished the forms that were used and the notes were negotiable. However, the GMAC conditional sales form in Braucher, Southerland, & Willcox, Commercial Transactions: Text, Forms, Statutes 36-40 (1953), does not include a note on the same piece of paper. Whether one is designed to be used with it does not appear. If this tendency does exist there is all the more reason to change the legal rules discussed here, since even their beneficiaries realize that they are no longer applicable.

pany which has this as its primary, if not sole, activity.[6] Both note and security device are almost always retained by the first assignee, the financer,[7] though they can be reassigned. The note will probably be transferred by the seller by endorsement either with or without recourse and the security device will be assigned with it. If it is purchased with recourse, the dealer holds the entire credit risk and must pay the financer if the buyer does not. If without recourse, the financer holds the credit risk and will not be able to look to the seller for reimbursement. An intermediate method is for the note and security device to be transferred with a repurchase agreement.[8] Under such an agreement the dealer will repurchase the chattel if the finance company repossesses it at a price equal to the amount of the loan unpaid. The dealer has no liability for the debt as such. This may enable him to escape showing the amount of the debt as a contingent liability on his books.

The seller will not usually advance credit to the buyer—and hence the note will not be signed—until he has received approval from the financer that it will buy the note of this particular buyer. The blank forms are provided by the finance company and usually contain a printed assignment or endorsement clause in which the name of the finance company is printed as the endorsee or assignee. The note may be "payable at" the office of the finance company. The finance company will furnish the seller with a table, by means of which he can compute the monthly installments that will be charged in any particular transaction, and a variety of other materials (having to do with insurance, refinancing, etc.). Although these purchases of consumer paper may be isolated transactions, they usually are not. They are normally carried on under an agreement of some type between the finance company and the seller providing for many such sales. Frequently this involves the financing by the finance company of the dealer's purchase of cars, or whatever, from the manufacturer.[9] In-

6. In December, 1957, $15,496,000,000 of automobile installment paper was outstanding; $7,470,000,000 was held by finance companies; $6,389,000,000 by commercial banks; $529,000,000 was in the hands of dealers. I cannot get the figures to add up. This may be because the total figure was compiled separately, perhaps at different dates from the separate figures; or, I may have overlooked some catchall category. However, the proportions appear approximately correct.

7. Interview with official in St. Louis Federal Reserve Bank.

8. Seidman 134-36. Forms "CC," "DD," "EE" and "FF." These arrangements are subject to immense variations.

9. One form of agreement provides in part: "We will repurchase any item of paper sold to you under this agreement on your request made at any time after default by the purchaser in the payment of any instalment continuing uncured for sixty-one days or more; or, if we breach any warranty in said paper, assignment, endorsement or any provision of this or any other agreement as to said paper and shall pay you an amount equal to your original investment, plus un-

deed the American Bankers Association recommends that banks buy all a dealer's paper. In order words, the whole transaction is, or may be, similar to the financing of a dealer or manufacturer by means of a combination of loans secured by inventory (field warehousing, factoring, etc.) and an assignment of accounts receivable. The retail paper is the more lucrative business and frequently the finance company will finance or "floor-plan" the dealer in order to get him to assign the retail notes to it.[10] This pattern of doing business arose during the 1920's when automobiles began to be sold in tremendous numbers, on "time," and it does not seem to have changed in essentials since then.

The problem that is under consideration arises for the most part when there is a default by the buyer on his note and the financer attempts to enforce the obligation. The buyer defends by asserting a defense that would be good against an action by the seller, such as fraud, failure or lack of consideration, payment, or rescission. Usually the seller has become insolvent or has absconded and hence if the financer wins against the buyer, the buyer's remedy against the seller is worthless. Similarly any warranty that the seller may have made to the financer is worthless. The financer asserts that it is a holder in due course, and consequently holds the instrument free of such defenses. Generally it wins, but occasionally it does not. In some of the cases in which it does not, it appears that the court regards the type of transaction described as being such that one in the position of the financer cannot be a holder in due course.

The principal difficulty in analysing these decisions is that there are many possible reasons why a financer would not be a holder in due course quite apart from the peculiarities of its relationship with the dealer. For example, there is always a possibility that the note is not negotiable because it is tied in too closely with the transaction and hence is not an "unconditional" promise.[11] Again, the financer

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collected accrued interest and any expenses of collection incurred by you after default by us, less all principal sums received by you on such paper (the aggregate amount thereof hereinafter referred to as 'repurchase price'). Payment is to be made within 30 days after your request for repurchase . . . . All paper repurchased by us hereunder shall be reassigned to us without recourse to you and without warranties, express or implied, and shall be delivered to us against payment to you in cash therefor at your office. . . . We waive presentment, demand, notice and protest as to all paper and consent that you may grant extensions of time and otherwise handle making collections in accordance with your business judgment." Seidman 134, Form "CC"—the agreement runs in form from dealer to financer.

10. Seidman 137-38; Phelps, Instalment Sales Financing: Its Services to the Dealer 31-37 (1953); Kripke, Inventory Financing of Hard Goods, 1956 Ill. L. Forum 580.

11. E.g., Von Nordheim v. Cornelius, 129 Neb. 719, 262 N.W. 832 (1935).

may have taken the note after maturity,[12] or with actual notice of defenses—not in good faith.[13] Or, perhaps the consideration it gave was not "value" in the sense of section 52 of the Negotiable Instrument Law, although this is unlikely. Even when these cases are eliminated, however, there remains a residue of cases in which it appears that the financer-seller relationship is alone responsible for the decision of the court.

So far as I have been able to find out, there are cases in eleven states[14] in which it has been held that the financer was not a holder in due course, or, in any event, purchased the paper subject to defenses because of the peculiarities of the relationship described here. I have found cases in nine states that consider this relationship between financer and buyer and hold for the financer.[15] In three of these states there are cases going both ways (which do not overrule each other).[16] In every state except two[17] in which there has been a decision for the financer there are other decisions in which, on what appear to be similar facts, an opposite result was reached. Usually, in such cases, the point was not raised but is inherent in the facts. Furthermore, although I have been unable to find any cases in the remaining states that have dealt with the issue expressly, there are, in all but eight[18] of these states, cases involving indistinguishable facts in which the point was apparently not raised. Of these forty-one states (including the District of Columbia) all but six[19] have cases that

12. E.g., Webb v. Orme, 35 Ga. App. 784, 134 S.E. 841 (1926).

13. E.g., Davis v. Commercial Credit Corp., 87 Ohio App. 311, 94 N.E.2d 718 (1950).

14. Since relatively few states have considered the problem of whether a financer in this situation is a holder in due course, separately from other purchasers of negotiable instruments, it is not felt that the normal citation of decisions that hold for one party or the other is meaningful. Consequently, all of the decisions that have been found have been placed in an appendix to this article where they have been arranged by states. A somewhat fuller discussion of the cases than would be feasible in ordinary footnote citation is thereby made possible. References to holdings will be made to states rather than to cases and the reader is referred to the appendix to see the cases in support of the statement. Thus, there are cases in the following states that have considered the question of whether a financer can be a holder in due course and have decided that he cannot: Arkansas, California, the District of Columbia, Florida, Iowa, Louisiana (possibly), Michigan (possibly), Missouri (possibly), New York, North Carolina, Pennsylvania (possibly), Texas (possibly).

15. Alabama, Indiana (possibly), Louisiana, Michigan (possibly), New Jersey (possibly), New York, Oklahoma, Tennessee, Wisconsin.

16. Louisiana, Michigan, New York.

17. California and North Carolina.

18. Colorado, Connecticut, Kentucky, Maine, Nevada, Oregon, Utah, Washington.

19. California, Iowa, Maryland, Minnesota, New Mexico, North Dakota.

decide for the financer, although the issue of his peculiar status is not raised. Similarly, in addition to the cases that hold for the buyer expressly because of the financer-seller-buyer relationship, there are cases in eighteen states that decide for the buyer on some other ground.[20]

Clearly then, the financer wins more often than not, but loses in a significant number of cases. This is the result that the general law of negotiable instruments would lead one to expect. There is a note in proper form endorsed by the payee to the financer for value. Accompanying the note—usually as a part of the same piece of paper, but separated by a dotted line—is a security device such as a chattel mortgage or conditional sale contract. Normally, the finance company was not a party to the sale in the sense that none of its officers was present when the sale took place or during the negotiations between buyer and seller that preceded it. It should therefore take the note free of all save "real" defenses (such as forgery, fraud in factum, insanity, etc.) against the seller. As holder in due course of the note, in addition to obtaining a right to a money judgment on the note against the maker, it can expect to acquire a security interest in the property that was the subject matter of the sale. It can enforce this interest by foreclosure, private sale, or however, in accordance with the terms of the agreement. The fact that one is an assignee of the security interest does not in any way affect one's status as holder in due course of the note. Quite the reverse. Since the security interest is security for the note, and the note is negotiable, the "security follows the debt."[21] Thus, since the finance company, as holder in due course, holds the debt free of personal defenses, it holds the security interest free of personal defenses. Hence, it should, as it does, win most of its cases.

Furthermore, in most of those cases that I have found in which the financer lost, except where the financer-seller-buyer relationship was expressly dealt with, the decision was quite orthodox. The financer could have expected to lose under the usual rules of negotiable instruments just as, in the other cases, he could expect to be found to be a holder in due course, and hence to win. This is seen by the holdings, e.g., the facts justified a finding that the financer made the seller his collection agent and hence was not a holder in due course;[22] the seller and financer were in fact one, since they had officers in common and

20. Alabama, Georgia, Indiana, Kansas, Louisiana, Michigan, Minnesota (allegedly applying Wisconsin law), Missouri, Nebraska, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, South Dakota, Texas.

21. Britton, Bills and Notes § 15 (1943).

22. C.I.T. v. Hurst, 23 Ala. App. 454, 176 So. 886 (1930).

the financer took part in the sale;[23] the buyer, by showing fraud showed that the financer's title was defective, hence the burden shifted to him to prove he was a holder in due course;[24] the seller was the financer's agent;[25] when one is assigned the conditional sales contract as well as the note, one takes with notice that the consideration may fail.[26] The other cases are similar.[27]

These are, as indicated, the results that one would expect in this field. There is doubtless no need to explain them since they fit into the traditional pattern of negotiable instruments law. There is, however, need to consider the other cases, the cases in which the financer loses because he is the typical financer described above. How are these cases to be explained?[28]

One reason, surely, is that the whole transaction as it is normally carried on is a sham. The transaction is really a loan by the financer to the buyer to enable him to buy a chattel from the seller. However, the papers are arranged in such a way that the loan is stated to be from seller to buyer, and the resulting debt is then said to be transferred to the financer. The transaction is not, in other words, what it appears to be. Whenever this is the case, there is always the possibility that a court can be talked into "piercing the veil," looking "through form to substance," etc.

Probably another reason is that the way the financer, seller, and buyer use negotiable notes is quite different from the way that the Negotiable Instruments Law assumes that such instruments will be

23. Commercial Loan Co. v. Baker, 37 S.E.2d 636 (Ga. 1946).

24. Peoples State Bank v. Hall, 83 Ind. App. 385, 148 N.E. 486 (1925).

25. International Harvester Co. v. Watkins, 127 Kan. 50, 272 Pac. 139 (1928).

26. Sloan Lumber Co. v. Ambrose, 26 S.W.2d 348 (Tex. 1930).

27. See the following cases under the appropriate state listing in the Appendix; Commercial Credit Corp. v. Freiler, 42 So. 2d 296 (La. App. 1949); G.M.A.C. v. Daigle, 72 So. 2d 319 (La. 1954); United States v. Roberts, 115 F. Supp. 786 (E.D. Mich. 1953); First & Lumberman's Nat'l Bank v. Buchholz, 220 Minn. 97, 18 N.W.2d 771 (1945); Progressive Finance & Realty Co. v. Stempel, 231 Mo. App. 721, 95 S.W.2d 834 (1936); Von Nordheim v. Cornelius, 129 Neb. 719, 262 N.W. 832 (1935); Veterans Loan Authority v. Rozella, 21 N.J. Super. 1, 90 A.2d 505 (1952); State Nat'l Bank v. Cantrell, 47 N.M. 389, 143 P.2d 592 (1943); Colonial Discount Co. v. Rumens, 249 App. Div. 736, 291 N.Y. Supp. 676, aff'd, 274 N.Y. 612, 10 N.E.2d 576 (1937); C.I.T. Corp. v. Joffe, 157 Misc. 225, 283 N.Y. Supp. 881 (1935), rev'd on other grounds, 162 Misc. 328, 293 N.Y. Supp. 659 (1937); Heiman v. Murphy, 143 Misc. 81, 256 N.Y. Supp. 20 (1932); Lincoln Nat'l Bank v. Marsh, 24 N.Y.S.2d 281 (1940); Advance-Rumely Thresher Co. v. Geyer, 40 N.D. 18, 168 N.W. 731 (1918); Davis v. Commercial Credit Corp., 87 Ohio App. 311, 94 N.E.2d 710 (1950); Mercantile Trust Co. v. Roland, 143 Okla. 190, 288 Pac. 300 (1930); C.I.T. v. Wesling, 53 S.D. 337, 220 N.W. 855 (1928); General Electric Contract Corp. v. Heimstra, 69 S.D. 78, 6 N.W.2d 445 (1942); Allied Building Credits, Inc. v. Ellis, 258 S.W.2d 165 (Tex. Civ. App. 1953).

28. See note 14 supra.

used. There is, and has long been, a definite policy behind the provisions of the Negotiable Instruments Law that give special protection to the holder in due course of a negotiable instrument. This is that the needs of commerce require that commercial paper be freely transferred, and it is believed that it cannot be freely transferred unless one who purchases it in good faith for value acquires a good title to the paper even though there may be defenses to it.[29] And when the law was developing, negotiable instruments were freely transferred from hand to hand.[30] It may be recalled that paper money first consisted of the notes of banks.[31] This expectation of free transferrability is reflected in the Negotiable Instruments Law, the whole structure of which indicates a belief that the instruments with which it is concerned will be negotiated or transferred, probably several times, before being collected.[32] The other documents which have been given

29. E.g., Story, Bills of Exchange 16-17 (4th ed. 1860): "Bills of Exchange in most, if not all, commercial countries, possess some peculiar advantages and privileges over common contracts. Some of these privileges are connected with the peculiar and summary remedies given to enforce the rights growing out of them; such, for example, as exist in France and in Scotland. Others are of a nature giving them a peculiar sanctity and obligation, and freeing them from the equities and cross claims which may exist between the original partes. These latter are allowed in order to give them a ready circulation, and extensive credit; and, indeed, they seem indispensable to protect third persons, who may become holders thereof, from injury and imposition. If, for example, the original parties to the instrument were at liberty to set up against a *bona fide* holder for a valuable consideration, without notice, any facts which might impèach its original validity, or might show, that it had subsequently become void, or that no consideration whatever passed between the original parties, or that the consideration had since utterly failed; it is obvious, that the credit and confidence due to the instrument would be essentially impaired, and it could not be safely relied upon as a means of remittance of money from one country to another, or even between different places in the same country. On the other hand, by shutting out all such defences against such a holder, the instrument has, for many practical purposes, become an equivalent to, and a representative of, money; and it circulates through the commercial world, as an evidence of valuable property, of which any person, lawfully in possession, may avail himself, to make purchases, to pay debts, and to pledge, as a security or indemnity for advances." See also Story, Promisory Notes 13 (7th ed. 1878): "Most, if not all, commercial nations have annexed certain privileges, benefits, and advantages to promissory notes, as they have to bills of exchange, in order to promote public confidence in them, and thus to insure their circulation as a medium of pecuniary commercial transactions."

30. See text at note 60 infra.

31. Waterman, The Promissory Note As a Substitute for Money, 14 Minn. L. Rev. 313, 321-30 (1930).

32. E.g., the elaborate provisions on presentment, protest, and notice of dishonor, Negotiable Instruments Law §§ 70-118, 143-160; further, the warranties of drawers and endorsers which are designed to run to subsequent holders obviously contemplate that there will *be* subsequent holders. Id. §§ 61, 64, 66.

the attributes of negotiability have, by and large, been of a similar character—it has been expected that they would be much negotiated, for example, bills of lading, warehouse receipts, and stock certificates.[33] And, as a matter of fact, they are negotiated—probably much more than notes. This property of negotiability is still extraordinary, however. The rules as to chattels and as to other choses in action remain as before. The bona fide purchaser of such an item gets what his transferor had and no more.[34]

The situation contemplated by the Negotiable Instruments Law is, thus, quite different from that of the financer, seller, and buyer as outlined here. Far from being a stranger to the transaction, the financer is the person to whom the obligation is intended to run, who furnished the consideration for it, and who will normally retain the instrument for collection. Consequently it would be possible to argue that since the privileges that are given to holders in due course are of a very special kind, different from those received by most transferees, and since these privileges were originally given to them to accomplish a particular purpose, a purpose not effected here, then there is no reason to extend the privileges.

It is, I believe, reasoning of this sort that has led some courts to hold that financers are not holders in due course. Of course, as one would expect, they have not explicitly adopted this line of reasoning[35] in arriving at a result in consonance with it. It is doubtless too brazen an approach even for a court that believes it, especially if there are any alternative ways of arriving at the same result—ways that are both conventional and discreet. Here, clearly, there are a great many. Two are outstanding: one can find that the instrument is non-negotiable or one can find that the transferee is not a holder in due course. Or, of course, both. These are attractive alternatives because each may be determined to be true for an almost infinite number of reasons. It is a rare negotiable instruments case that will not have some elements that can, if necessary, be twisted plausibly to permit the required finding. Both reasons have been used by the courts.

Thus, there are quite a few cases in which it is "held" that the note is non-negotiable because it is bound up with a chattel mortgage and the mortgage contains clauses that either make the promise to pay conditional or the time in which it is to be performed uncertain.[36]

33. All of these instruments can be given the attributes of negotiability. Uniform Bills of Lading Act § 5, Uniform Warehouse Receipts Act § 5, Uniform Stock Transfer Act §§ 1, 5, 6, 8.

34. Brown, Personal Property §§ 67-72 (2d ed. 1955).

35. Essentially, cessante ratione legis cessat et ipsa lex.

36. E.g., Old Colony Trust Co. v. Stumpel, 126 Misc. 375, 213 N.Y. Supp. 536, aff'd, 219 App. Div. 771, 220 N.Y. Supp. 893, aff'd without opinion, 247 N.Y. 538, 161 N.E. 173 (1928). See also Annot., 44 A.L.R.2d 8, 59-63 (1955).

This doctrine has two weaknesses, however. In the first place, there is a very strong and ancient rule supported by the Negotiable Instruments Law itself that negotiability is not affected by a mere reference in the instrument to the security.[37] Therefore, it is easy to phrase the note in such a way that it is not "subject to" the mortgage and hence the terms of the mortgage are irrelevant to the note. There may be more trouble if the financer attempts to enforce the lien instead of, or in addition to, suing on the note.[38] Even in that situation, however, the financer will usually prevail since, as indicated above, the "security follows the debt," an assignment of the debt is automatically an assignment of the security, and the security partakes of the nature of the note. Thus, even though note and mortgage are printed on the same sheet of paper, separated only by a dotted line, one who is assigned the note is not affected by anything printed above the line even though he is assigned that too.[39] Presumably he averts his eyes.[40]

Even if a particular instrument is held to be negotiable, however, it is still possible for a court to hold for the buyer by finding that the financer is not a holder in due course. The requirements that the financer must meet are set out in section 52 of the Negotiable Instruments Law, as follows:

> A holder in due course is a holder who has taken the instrument under the following conditions:
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> 1. That it is complete and regular upon its face;
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> 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;
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> 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.

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37. Negotiable Instruments Law § 5(1) (negotiability not affected by provision which authorizes sale of collateral on default). Britton, Bills & Notes § 15 (1943).

38. See, e.g., Mercantile Trust Co. v. Roland, 143 Okla. 190, 288 Pac. 300 (1930).

39. See Britton, Bills & Notes § 15 (1943).

40. See Beutel, Negotiability by Contract, 28 Ill. L. Rev. 205 (1934).

Another doctrine may be available in aid of the financer, and that is "negotiability by contract." Under this theory the conditional sales contract itself (or perhaps the chattel mortgage, though this would be unusual) can be made negotiable in effect. Usually this is accomplished by placing in the instrument a clause waiving against an assignee defenses that might have been available against the seller. This doctrine is not universally accepted by any means, but it seems to be firmly established in some jurisdictions. See also Annot., 44 A.L.R.2d. 8, 92-96, 162-72 (1955); Note, 5 De Paul L. Rev. 149 (1955).

Since "value" includes past consideration[41] there is rarely any question of this. Nor is there usually any question of maturity since the notes are assigned to the finance company almost as soon as they are signed, or in any event long before maturity. The requirement that the instrument be complete and regular on its face will probably arise only in rather special circumstances, as, if the note does not have a due date and is not payable on demand.[42]

The remaining requirement is quite important, however, and does offer a chance for the court to find that the finance company is not a holder in due course. This is the requirement of notice. Section 56 provides:

> To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith.

In order to be charged with bad faith, the transferee must actually *know* of the defect in the instrument.[43] In the situation being dealt with here, this defect will have something to do with the sale. The object sold may not have been delivered or it may have proved defective, or the seller's title to it may have been defective so that it was replevied from the buyer by the true owner. One may assume that all of these assertions would, if proved, be good defenses against the seller. If the finance company took the instrument with knowledge that they existed, it would not be a holder in due course. In fact, however, it is most unlikely that a financer will know anything about a particular sale, or that it would intentionally collude with a dishonest seller. Obviously cases exist where financers have joined in fraudulent schemes.[44] But a dishonest seller is just as likely to attempt to defraud the finance company as a retail buyer. Indeed, one fairly common device of such individuals is to assign the finance company paper that apparently arises out of sales of chattels when these sales have never, in fact, taken place. Consequently, it is not necessary to impute an inordinate amount of virtue to the finance company to assume that the cases of actual knowledge of fraud will be few. Yet the statute requires actual subjective knowledge at the time the instrument is assigned in order to charge the assignee with bad faith. Thus, one would expect this argument to have little success. And it does not,

41. Negotiable Instruments Law § 25.

42. See Remedial Plan v. Ott, 188 Ky. 161, 250 S.W. 825 (1923).

43. Britton, Bills & Notes §§ 100, 101 (1943).

44. Taylor v. Atlas Security Co., 213 Mo. App. 282, 249 S.W. 746 (1923) may well be such a case. See Appendix.

though it has more than the first arguments mentioned. There are some cases that stretch the doctrine to include the financer.[45]

How then can a court without too radically twisting the traditional rules find for the buyer if it wishes to? The only feasible way seems to be to start at the other end of section 52 and look into the transfer to the financer. In form, of course, there is negotiation since there is endorsement by the named payee and delivery.[46] Obviously, however, if an individual has an agent acquire a negotiable instrument for him, though it is drawn to the order of the agent, still the principal is the beneficial owner of the instrument. His position vis-a-vis the maker is not improved or changed by his going through the form of negotiation. He was the real party all along and remains so. And this is precisely the situation of the financer. Hence *it* is not a holder in due course.

This, it is believed is what, in fact, those courts do, though they may not do so in so many words. Some, however, that have held for the buyer *do* use almost this language. Thus the Arkansas court in *Commercial Credit Co. v. Childs* said:

> [Plaintiff] was so closely connected with the entire transaction or with the deal that it cannot be heard to say that it, in good faith was an innocent purchaser of the instrument for value before maturity. . . . Rather than being a purchaser of the instrument after its execution, it was to all intents and purposes a party to the agreement.[47]

And the California court in *Commercial Credit Corp. v. Orange County Machine Works* said:

> Throughout the entire transaction, Commercial Credit dealt chiefly with Ermac, the future payee, rather than with Machine Works, the future maker. . . . In a very real sense the finance company was a moving force in the transaction . . . .[48]

Perhaps the strongest statement was by a jüdge of the City Court of Buffalo, New York. He wrote, in an opinion:

> It is obvious that here we have a factual joint enterprise in which, so far as conditional sales are concerned, the management

45. Palmer v. Associates Discount Corp., 124 F.2d 225 (D.C. Cir. 1941) (the close relationship with seller is evidence that financer had notice of defenses—he had the burden of proving himself holder in due course); Zier v. Eastern Acceptance Corp., 61 A.2d 106 (D.C. Munic. App. 1948); Mutual Finance Co. v. Martin, 63 So. 2d 649 (Fla. 1953); Allied Building Credits v. Mathewson, 335 Mich. 270, 55 N.W.2d 826 (1952) (semble); Taylor v. Atlas Security Co., 213 Mo. App. 282, 249 S.W. 746 (1923).

46. Negotiable Instruments Law § 30.

47. 199 Ark. 1073, 1077, 137 S.W.2d 260, 262 (1940).

48. 34 C.2d 766, 771, 214 P.2d 819, 822 (1950).

> rests in the far larger part in the hands of the finance companies. The finance company and the merchant-seller are as a fact engaged in one business, like Longfellow's description of man and woman, useless one without the other. To pretend that they are separate and distinct enterprises is to draw the veil of fiction over the face of fact.[49]

It does seem that these courts are right insofar as they hold that a financer should not be in any better position by going through these motions than if it lent money direct to the buyer. But neither should it be in any *worse* position. Yet, if these cases are followed to any great extent, it will be. After all, the buyer could very easily have borrowed the money to buy a car directly from a bank and given it a note and chattel mortgage. If the car was defective or not delivered, no one would suppose that these would be matters which would concern the bank. The buyer signed a note to the bank's order for money which the bank was to lend him. The bank lent him the money. It is entitled to get it back. If the buyer spent the money foolishly or was defrauded, that is not the bank's affair. The buyer must look elsewhere for whatever relief he can get. It is difficult to see why this should not be true of the financer in the present situation. Yet under the decisions of the courts that have been referred to, it is not true. When those courts look through the transaction, instead of seeing a loan from financer to buyer, they see an identity between seller and financer. Hence defenses that are good against the seller are good against the buyer.

Apart from getting these courts to overrule themselves and preventing others from following them or getting helpful legislation, what can the financers do to avoid this result?

One thing they could do is to arrange the transactions as what they really are. In other words, they could lend money direct to the buyer and get the security interest back. There seem to be only two substantial reasons why they should not carry on their business this way, and they are not very convincing ones. One is that the seller frequently endorses the note "with recourse." Thus if the buyer does not pay, the seller must. But this result would be accomplished if the seller guaranteed payment by signing as accommodation party, either maker or endorser according to taste. Or the seller and financer could enter into a separate guaranty agreement. The other reason is that it is very difficult to use a conditional sales contract in this transac-

49. Buffalo Industrial Bank v. De Marzio, 162 Misc. 742, 744, 296 N.Y. Supp. 783, 785-86 (1937). The effect of such a view is not limited to this problem. An out-of-state financer may be regarded as so closely related to the seller that he is "doing business" in the seller's state with all that that entails. See Note, The Effect of Qualification Statutes on Unlicensed Foreign Corporate Commercial Finance Companies: The Doing Business Concept, 1956 Wash. U.L.Q. 450.

tion unless it is arranged in the usual way. While the conditional sales contract has been stretched until it is almost the exact equivalent of the chattel mortgage—in other words a security device—it must still arise out of a sale. The borrower must agree to buy the car, and return it if the installment payments are not made, and this agreement must run to the actual seller. However, it is difficult to see what advantages there *really* are to conditional sales contracts nowadays. Traditionally they did not have to be recorded if there was a default in payment; there was a total forfeiture of payments already made; and it was easy to disguise a usurious rate of interest in a "time" price that would be more than a "cash" price—the difference by some legerdemain has never (or rarely) been regarded as interest. (Why, it is difficult to imagine.) Presently, however, in most states, conditional sales contracts do have to be recorded to be valid against bona fide purchasers.[50] Furthermore, there are, in many states, statutes requiring that any surplus that results from a sale of a repossessed article must be paid over to the buyer.[51] In any event, in most cases there will be no surplus. The effort is almost always to collect a deficiency judgment for the amount still due on the note after the collateral is sold. Usury is perhaps important. It seems quite likely that most consumer installment loans are made for rates that are, in fact, in excess of the statutory rates. This is usually accomplished by setting a different price for a sale for cash and a sale on "time." Since parties are free to agree to whatever price they choose, this difference is not interest but the additional price the buyer pays for not paying cash.[52] Financers might very well have a lot of trouble getting courts to uphold similar arrangements if the loans were made direct.[53] It is difficult to disguise interest as a service charge if all that the borrower gets is money. It is perhaps needless to comment on this aspect of the problem.[54]

50. The development of the conditional sales contract as a security device and its present use and misuse are discussed in some detail in Gilmore & Axelrod, Chattel Security: I, 57 Yale L.J. 517, 541-48 (1948).

51. E.g., Uniform Conditional Sales Act § 18 (permitting redemption after retaking by the seller); § 21 (surplus proceeds of sale to be repaid to buyer).

52. 6 Corbin, Contracts § 1500 (1951); Comment, Usury in Installment Selling, 9 Ala. L. Rev. 319 (1957).

53. 6 Corbin, Contracts § 1500 (1951).

54. Of course there are many valid arguments that can be made against the usury statutes. But I wonder if it is a good idea for courts to substitute so readily their ideas about the wisdom of having a maximum rate of interest for the clearly expressed intention of the legislature. There is surely something to be said for making the interested parties get the legislature to change the law. Banks, finance companies, et al., are not, after all, without resources. The Arkansas Supreme Court has had the unusual tendency of seeing interest rather than service charges in this situation, though it is dealing with a constitutional pro-

Even if all this is admitted, however, it may well be asked what possible difference it all makes. Even though there are adverse cases and the results could be avoided with relatively little trouble, financers are clearly making a great deal of money the way things are.[55] If there are a few cases—even quite a few—against them, they can predict approximately what the adverse decisions will cost them and charge this off as a business expense. Perhaps they can raise their rates a few decimal points to compensate. There are not so many defaulting sellers or stubborn buyers as to create a great problem.

In answer one can only say that in the first place the problem is one that does arise from time to time in the courts. Consequently, lawyers have to find cases and arguments on both sides of the question. It is hoped that this article may be of some aid in such endeavors. That is one of its purposes. However, it is not the only purpose. It is believed that these cases point up a problem in the law of negotiable instruments that has been developing for generations and that has received almost no consideration. That is, the case of the negotiable instrument which is never negotiated. The reverse problem—the non-negotiable instrument which *is* negotiated—has received a great deal of attention. So, in the Uniform Commercial Code, article 5 deals with documents of title to goods and provides that they may be negotiable, and article 8 does the same for investment securities although the documents so treated are not "negotiable instruments" in the traditional sense. Article 3, however, which deals with roughly the same subject matter as the Negotiable Instruments Law, except as particular instruments may be treated in other articles, is in most respects quite similar to the statute it replaces. The changes are in detail—as opposed, say, to article 2 on sales, or article 9 on secured transactions, where the whole approach of the law is changed. But, as indicated above, the notes that are involved in installment sales are not often negotiated in the sense of being passed from hand to hand. And the

hibition. See Sloan v. Sears, Roebuck & Co., 308 S.W.2d 802 (Ark. 1957). This case has induced a state of mild frenzy in the finance companies. See Higgins, Arkansas Supreme Court Rejects Rule That a Time Sale is not a Loan, 12 Personal Finance L.Q. Rep. 66 (1958).

55. Commercial Credit Corporation had a net income in 1957 of $26,777,876, or $5.31 per share of an equity value of $41.47. 2 Standard & Poor's, Standard Corporation Descriptions 3947 (1958). C.I.T. had a net income in 1957 of $39,092,388, or $4.27 per share (9,157,141 no par shares carried at $56,774,274); GMAC had $46,037,000 ($50,000,000 4% par $100 preferred shares, $100,000,000 par $100 common). $22,000,000 was paid in dividends. The earned surplus on 31 December 1957 was $123,831,963 (up approximately $24,000,000 from the preceding year). The total volume of business for GMAC was $9,808,394,000; for C.I.T. $5,257,949,468. The bulk of their operating capital comes of course from long and short term loans. The figures for C.I.T. are from Moody's, Banks and Finance 1277 (1958); for GMAC, id. at 1316.

same is true of many other negotiable instruments, notably checks, most of which go from payee to bank and thereafter remain in banking channels.[56]

This fact should, I believe, be considered by all who are interested in commercial law, and for that matter in "law." This is because the Negotiable Instruments Law is applied to many situations with which it was not designed to deal. It can be so applied only by resort to what is, in effect, a legal fiction. While legal fictions serve a useful, and doubtless essential, function in law,[57] their use can be quite dangerous. Laymen almost always regard them with suspicion, hatred or contempt. If a layman loses a lawsuit solely, as he thinks, because of lawyers' hocus pocus, he will be, at the least, annoyed, perhaps enraged. He will blame the law and feel that it does not do justice. This attitude is, I think, bad.[58] Furthermore an overuse of legal fictions

56. In a way, perhaps, checks are a bad example since their collection is governed by special law, such as the Bank Collection Code and article 4 of the Uniform Commercial Code. Still these statutes do not deal with the problem of negotiability. They simply recognize, implicitly, that "negotiation" has little to do with the problems that banks have with checks—their basic problem being to throw any loss that may occur in collection onto some solvent person in the collection chain. In England the problem has come more out into the open. Checks need no longer be endorsed if they are deposited in the payee's bank for collection. Cheques Act, 1957, 5 & 6 Eliz. 2, c. 36.

57. See Maine, Ancient Law 13-25 (Everyman ed. 1954).

58. This specific problem has, as a matter of fact, received a scathing comment in a national magazine, and this, needless to say, is not the fate of most problems in the law of bills and notes. (Most such problems do not receive much attention even in law reviews.) See Brecher, Ballard v. The Installment Goliaths, Harpers' Magazine, Sept., 1956, p. 63. The comments of the authors on the procedure described here are an interesting example of laymen's attitudes. They write:

"It may seem obvious to you that the bank or finance company has lent you the money to pay for the car—but don't jump to any such conclusion. The apparent lender insists that he really hasn't lent anything at all; he has merely 'purchased' the conditional sales contract or CSC from the dealer (not the borrower) at a 'discount.'

"Why do dealers and lenders bother to dance this legal minuet? Two answers suggest themselves. First, . . . the lender usually escapes the usury prohibitions. . . .

". . . .

"The second obvious reason for dancing the CSC minuet is to make available certain highly convenient methods of collection and repossession.

". . . .

"Maybe justice really isn't fo' po' folks," one of the lawyers remarks in his quiet Alabama drawl.

". . . .

"Here and there across the country, a few other courts in little-publicized cases have been willing to take off their blinders and to look through the CSC 'paper bag' to the usurious contents of the bag."

prevents an intelligent analysis of a problem because the problem tends not to be approached as what most people, even lawyers, think it is, but rather as something that it is not, although it bears the name. As long as it is clear to everyone that the fiction is simply an empty ritual, doubtless no harm is done. But if the fiction is confused with fact—and this I believe is the case here—good results in cases will be accidental. Thus it did no harm to presume that all contracts brought before the court of King's Bench were made "in the parish of St. Mary-le-Bow in the ward of Cheap" even though in fact a contract might have been made in Leghorn, since this assumption gave the court jurisdiction and it was always regarded as a fiction.[59] If, however, the court would have refused to let the plaintiff introduce evidence regarding transactions that took place in Leghorn because he had pleaded that the contract was made in London, the results would have been chaotic. This, it seems to me, is about what has happened in negotiable instruments law.

Perhaps this argument will be made clearer by a brief examination of the history of negotiable instruments in the common law.[60] It may be recalled that there were negotiable instruments and a law (or custom)—the law merchant—regarding them before they appeared in the common law courts.[61] At the time (the 17th century), the com-

The particular incident that sparked the article was the repossession of a truck, after default in payments under a note and conditional sales contract which had been assigned to a financer. There was the usual usurious interest rate disguised as a difference between the cash price and the time price. Usury was raised as a defense in the repossession (detinue) action in the state court. Ballard v. First Nat'l Bank, 261 Ala. 594, 75 So. 2d 484 (1954). Then some other truckers in the same situation as Mr. Ballard brought an action against the financer, a national bank, for recovery of double the amount of usurious interest paid under 13 Stat. 108 (1864), 12 U.S.C. §§ 85, 86 (1952). Providing for such an action the Court of Appeals for the Fifth Circuit decided that the time price —cash price differential was usury. Daniel v. First Nat'l Bank, 227 F.2d 353, rehearing denied, 228 F.2d 803 (5th Cir. 1956).

59. Otherwise the common law courts did not have jurisdiction over contracts that were made and designed to be performed abroad. Actually the plaintiff averred that Leghorn was in the parish of St. Mary-le-Bow, etc. 5 Holdsworth, History of English Law 140-42 (2d ed. 1937).

60. This history is generally examined in 1 Holdsworth, History of English Law 571-72 (7th ed. 1956); 5 id. 151-77 (1926). See also Holden, History of Negotiable Instruments in English Law (1955), especially 21-143.

61. Pace Dr. Holden, op. cit. supra note 60, at 4-13, it seems to me that the important aspect of the history is that there were instruments that performed most of the functions of negotiable instruments in use in England centuries before the development of negotiable instruments law in the common law courts. Indeed, in the medieval period obligations could be represented by notched sticks of wood, called tallies, that could be transferred. Salzman, English Trade in the Middle Ages 25-28 (1931). See also Postan, Private Financial Instruments in Medieval England, 23 Vierteljahrschrift für Sozial-und Wirtschafts-Geschichte

mon law courts did not recognize the rights of the assignee of choses in action, and of course they did not (as they do not) recognize the right of a bona fide purchaser to cut off legal interests. Both of these doctrines—free assignability, and the cutting off of defenses by a good faith purchase—were recognized by the law merchant in connection with negotiable instruments. Further, it was (and is) possible to have an enforceable right under a negotiable instrument that was not supported by consideration as that concept was applied in the case of other choses in action.[62] When the common law courts began to entertain actions on negotiable instruments, they did not change the law of contracts (or more accurately, perhaps, the law of assumpsit) to conform with the law of negotiable instruments. Rather, they enforced negotiable instruments as they thought the merchants enforced them (with a little backing and filling to be sure). The plaintiff did not declare on the promise, express or implied, as in the normal contract action of assumpsit. He declared on the custom of merchants. Originally, indeed, it was necessary that he be a merchant. Negotiable instruments were treated in a special way, and, naturally enough, only those instruments that clearly were of the type that merchants used were treated as merchants would treat them. Or, in other words, only such instruments had the law merchant rather than the common law of contracts applied to them. The law merchant became, of course, a part of the common law but that part of it that related to negotiable instruments did not become a part of the law of contracts. It remained separate. And it did not apply to all obligations to pay money but only to those that were regarded as legitimate descendants of the mercantile instruments that were its original subject—bills and notes. Obviously then, when the cases were codified this aspect was codified as well, and section 1 of the Negotiable Instruments Law and section 3-104 of the Uniform Commercial Code provide descriptions or definitions of the instruments to which the statutes apply. Only instruments meeting the standards there set forth are negotiable and acquire the legal characteristics that the acts give such instruments. These include free assignability (no longer too important since most choses in action are freely assignable) and freedom from defenses.

So far the development seems sound and unexceptionable. The original policies have been retained and are still relevant. Clearly

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26 (1930). Thus the mercantile community was quite used to having symbols other than "money" by means of which credit could be transferred.

62. It is perhaps enough to mention the problem of the liabilities of the maker of an order instrument which is endorsed in blank by the payee, stolen from the payee's transferee, and finally sold by the thief to one who becomes a holder in due course and hence is able to hold the maker liable.

there are still many bills and notes that are handled in almost the same way as their predecessors two centuries ago. And doubtless there are reasons for distinguishing them from other choses in action. Here lies the difficulty, however. Legal definitions have two tendencies. They exclude things that do not come within them. So here, no instrument that fails to fit the standard is covered by the statute. But they include anything which does come within the terms and treat it as the law provides that things so defined should be treated. Thus any obligation or chose in action which fits the definition of a negotiable instrument *is* a "negotiable instrument" with all its properties. This will be true even though it is not at all the sort of thing that is passed from hand to hand in normal commercial intercourse and hence is expected by the merchants into whose hands it comes to have the attributes of negotiability. Thus the consumer installment notes are negotiable though locked in a vault from signing to payment.

The problem arises from the definition which refers only to the surface characteristics (unconditional promise to pay money in writing, etc.) and not to the essential nature of the thing defined. It is as though an Englishman were defined as a man of above average height with a ruddy complexion, fair, but not overly fair hair, bad teeth, and a tendency to stammer and say "By Jove." Then any man who was above average height, etc., would be an Englishman. So here, a law was developed to apply to certain types of obligations which perform the function of enabling credit to be transferred easily. Such obligations were called negotiable instruments and some of their characteristics were described in a statute. There are other instruments which are given those described characteristics but which do not perform the functions of the original obligations at all. They are made to look like those obligations only to acquire the special rights that the statute gives them. And the courts say the statute does gives them these rights.

This problem of definitions is a common and doubtless unavoidable one, since it is impossible to frame a definition of manageable size that includes every attribute of the thing defined. In this area it has resulted in a complete reversal of the policy of the statute and the cases that preceded it. The limitation has resulted in an extension. But it is an unnecessary extension. Merely because lawyers have called a loan that is in fact from A to B, a loan from C to B that is assigned to A, does not mean that courts must agree. They need not, in consequence, say that since the loan is represented by a negotiable instrument no defense that is available between C and B is available against A. Or, disliking the result say, but perhaps this instrument is not negotiable because it refers to the instrument (such as a chattel mortgage) which secures its payment. Then, later if an in-

strument which is negotiated freely like a bond comes before the court, the former decision will perhaps require the result that the bond which is in fact negotiated from coast to coast, is *not* negotiable. All of this is, I believe, as indicated above, the result of the use of legal fictions, the fiction being that an instrument, which is not in fact negotiable since it is not and is not intended to be negotiated, is said to be negotiable because in some respects it looks like instruments that are negotiable. Then decisions involving the two types of instrument will be digested, and hence cited, under the same heading —the result is chaos. But a court could say that this definition is not exhaustive. It expresses some characteristics of negotiability but not all. This instrument is outside the act despite its form.

If courts will not do this, then surely it is the task of legislation. The problem is not limited to the fact situation considered here. Other types of so-called negotiable instruments are also not negotiated. What the solution should be I cannot now suggest. Doubtless it would not be simple. The official complete edition of the Uniform Commercial Code covers 711 pages. But before there can be solutions there must be a recognition of the problems. It is hoped that this article has shown one of them.

APPENDIX

As indicated in note 14, all of the cases that I have found that I regard as fairly relevant are collected here and grouped by states. A caveat should be entered. This collection of cases does not purport to be an accurate summary of the case law that pertains to this subject. There are two reasons for this. The first is that is is extremely difficult to make sure that one has got all the relevant cases in any field, even for one not very litigious state. It is very nearly impossible to do so for the country as a whole. The problem is complicated by the fact that the effort has been to find cases with the typical fact situation regardless of what rules of law were applied. In the second place this article deals with a specialized aspect of a much litigated problem —whether a particular holder is a holder in due course. The larger problem is not restricted to installment sales and all of the cases that do deal with such sales are decided within the larger context. Consequently one cannot really make too accurate a statement about the law in, say California, unless, in addition to the cases cited here, one is also familiar with all of the other cases that the California courts have decided on what constitutes notice, usual course of business, good faith, and the like.

No effort has been made to present a unified and coherent picture of the "law" of any state since it is believed that any order that might thereby be achieved would be entirely factitious. Almost any one of

these cases could have been decided the other way by the same court.

The Uniform Commercial Code is not discussed since there is apparently only one provision that particularly affects this problem. This is section 9-206, which provides that in the case of consumer sales the financer is subject to defenses good against the seller if he attempts to assert his security interest in the goods.

It should be assumed that the facts in the cases cited are roughly the same as those indicated in the text at note 3 unless otherwise indicated.

Alabama:

In general the Alabama courts appear to have regarded the financer as a holder in due course and as not subject to any defenses that might have been available against the seller. The typical fact situation is set out in some detail in *Singer v. Nat'l Bond & Inv. Co.*, 218 Ala. 375, 118 So. 561 (1928), where the financer won despite various defenses. In that case, the note and chattel mortgage forms were prepared by the financer and, as printed, they were made payable at its office. There was a previous case arriving at the same result in connection with a defense of usury, *Commercial Credit Co. v. Parks,* 215 Ala. 648, 112 So. 237 (1927). And similar results have been reached subsequently. *Royal Tire Service, Inc. v. Shade Valley Boys' Club,* 232 Ala. 357, 168 So. 139 (1936) (rather special facts which tend to throw suspicion on the good faith of the financer's acquisition) ; *Commercial Credit Co. v. Seale,* 30 Ala. App. 440, 8 So. 2d 199 (1942) (apparently the conditional sales contract was held to be negotiable in itself) ; *Cotton v. John Deere Plow Co.,* 246 Ala. 36, 18 So. 2d 727 (1944). However, in *C.I.T. v. Hurst Bros.,* 23 Ala. App. 454, 126 So. 886 (1930), the buyer was able to prevail in his claim in breach of warranty against the financer. The seller had told the buyer that it was turning the paper over to the financer for collection. The paper was made payable at the plaintiff's place of business in New York. The buyer wrote to the financer and asked if he might pay the financer. Plaintiff replied he could. It had these papers for collection. The court held that these facts justified a finding that the plaintiff was a collection agent of the seller and not a holder in due course. The case has never been cited since, according to Shepherd's, except in the A.L.R. annotations. In *Daniel v. First Nat'l Bank,* 228 F.2d 803 (5th Cir. 1956) the court indicated that this type of transaction might well be regarded as a loan from financer to buyer, although there were other factors which led them to hold for the buyer. The financer also won in *Ballard v. First Nat'l Bank,* 261 Ala. 594, 75 So. 2d 484 (1954). See note 58 supra.

Arizona:

In the only case that has been found with the typical fact situation, the financer won. However, there was no discussion of any problems peculiar to financers. *Rugee v. Hadley Products, Inc.,* 73 Ariz. 362, 241 P.2d 798 (1952). In a similar situation, involving a corporation organized to make loans to distressed cattle owners through local banks, the financer won. The court refused to hold that the financer was the *real* mortgagee. *Stock Growers Finance Corp. v. Hildreth,* 30 Ariz. 505, 249, Pac. 71 (1926).

Arkansas:

Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W.2d 260 (1940) is usually cited as one of the leading cases for the proposition that the financer is not a holder in due course. It has never been overruled nor did it purport to overrule any previous decisions. However, there were previous decisions in favor of financers. See, e.g., *Davis & Worrell v. G.M.A.C.,* 153 Ark. 626, 241 S.W. 44 (1922); *Trice v. People's Loan & Inv. Co.,* 173 Ark. 1160, 293 S.W. 1037 (1927); *McClain v. Patterson,* 177 Ark. 544, 7 S.W.2d 8 (1928); *General Contract Purchase Corp. v. Holland,* 196 Ark. 675, 119 S.W.2d 535 (1938). The result of the *Childs* case has been reached in subsequent Arkansas cases, e.g., *Bastian-Blessing Co. v. Stroope,* 203 Ark. 116, 155 S.W.2d 892 (1941) (citing *Childs* case); *Gale & Co. v. Wallace,* 210 Ark. 161, 194 S.W.2d 881 (1946); *Schuck v. Murdock Acceptance Corp.,* 220 Ark. 56, 247 S.W.2d 1 (1952). However, the financer has also won in some cases subsequent to the *Childs* case on facts which are very similar, although that case and the issues raised there were not discussed. See *Garst v. General Contract Purchase Corp.,* 211 Ark. 526, 201 S.W.2d 757 (1947) (principal issue was usury); *Public Loan Corp. v. Terrell,* 224 Ark. 616, 275 S.W.2d 435 (1955) (the buyer did not file a brief; the *Childs* case was not cited).

California:

Commercial Credit Corp. v. Orange County Machine Works, 34 C.2d 766, 214 P.2d 819 (1950) is another leading case against the financers' holder-in-due-course status. There appears to be little other California law on the point although a later federal case seems to reaffirm this view. *United States v. Klatt,* 135 F. Supp. 648 (S.D. Cal. 1955) (alternative holding). There is an earlier appeals case which affirmed a judgment for the financer. *People's Bank v. Porter,* 58 Cal. App. 41, 208 Pac. 200 (1922). This case was cited in the decision by the court of appeal for the financer in *Commercial Credit Corp. v.*

Orange County Machine Works, 208 P.2d 780 (Cal. App. 1949). It was not, however, cited by the supreme court in its decision in the same case (cited above) for the buyer.

Colorado:

I have found no cases in Colorado.

Connecticut:

I have found no cases in Connecticut.

Delaware:

In *Continental Guaranty Corp. v. Peoples' Bus Line,* 31 Del. 595, 117 Atl. 275 (1922), there was a decision for the financer. However, it was simply assumed that if the note was negotiable, the financer was a holder in due course.

District of Columbia:

One case in the District contains language that would seem to indicate that the typical fact situation set out above is in and of itself evidence, though not conclusive evidence, that the financer is not a holder in due course. *Palmer v. Associates Discount Corp.,* 124 F.2d 225 (D.C. Cir. 1941). This position receives some support in *Zier v. Eastern Acceptance Corp.,* 61 A.2d 106 (D.C. Munic. App. 1948) in which a directed verdict for the financer was reversed. The financer had the burden, under the facts, of showing himself a holder in due course; the fact that the note was on a form furnished by the financer and payable at his office was not determinative but might show mala fides. However, subsequent cases have held for the financer consistently and although the facts in the cases were "distinguishable" from those in the *Palmer* case, (what case cannot be distinguished?) and were "distinguished" by the courts, the atmosphere in the Municipal Court of Appeals, as opposed to the United States Court of Appeals, is apparently favorable to financers. See *Wilson v. Gorden,* 91 A.2d 329 (D.C. Munic. App. 1952); *McDonald v. Stone,* 86 A.2d 624 (D.C. Munic. App. 1952); *Fabrizio v. Anderson,* 62 A.2d 314 (D.C. Munic. App. 1948); *Eastern Acceptance Corp. v. Henry,* 62 A.2d 309 (D.C. Munic. App. 1948).

Florida:

Mutual Finance Co. v. Martin, 63 So. 2d 649, 44 A.L.R.2d 1 (Fla. 1953) is one of the leading cases for the proposition that the closeness of relationship between financer and the transaction between buyer and seller is sufficient to prevent it from being a holder in due course

and indeed the court's language is very strong. There is some indication that an officer of the seller had stock in the financer, but this fact (if it was a fact) is not dwelt upon. The court expressly limits its holding to the proposition that *"under the facts shown in this record* the finance company had . . . notice of the note's infirmity . . . ." Id. at 653, 44 A.L.R. at 7. The *Martin* case was distinguished, however, in *Citizens & Southern Nat'l Bank v. Stepp,* 126 F. Supp. 744 (N.D. Fla. 1954). The district judge stated that in the *Martin* case the name of the financer appeared on the note and contract as the only person to whom they could be assigned. In addition, the seller was a stockholder of the finance company and the finance company participated in the sale. None of these conditions was present in the instant case.

Georgia:

The position of the finance company as distinguished from other putative holders in due course does not appear to have been considered. However, financers recovered as holders in due course; see *Peoples Loan & Finance Corp. v. Latimer,* 183 Ga. 809, 189 S.E. 899 (1937) ; *Southern Security Co. v. American Discount Co.,* 184 Ga. 82, 190 S.E. 350 (1937) ; *Sterling Discount Corp. v. Hooks,* 56 Ga. App. 541, 193 S.E. 182 (1937) ; *Peoples Loan & Finance Co. v. Ledbetter,* 69 Ga. App. 729, 26 S.E.2d 671 (1943). See also *Howard v. Trusco Finance Co.,* 87 Ga. App. 509, 74 S.E.2d 379 (1953) (dictum). On the other hand, the buyer recovered for conversion against the financer who had replevied the car in *Commercial Auto Loan Co. v. Baker,* 73 Ga. App. 534, 37 S.E.2d 636 (1946) because, inter alia, there was evidence from which a jury could find no real third party in the case. The financer was apparently much more involved in the transaction than is usual: it had an officer in common with the seller and there were extended negotiations among seller, financer and buyer on the terms of the loan; an officer of the financer apparently filled out the note form contrary, it was asserted, to the plaintiff's instructions. The opinion is quite confused but apparently the court felt that there was fraud in the inception of the agreement to which the financer was a party and hence it could not be a bona fide purchaser. The case was cited later in *Howard v. Trusco Finance Co.,* supra, for the proposition that "where a conditional-sale contract is filled in contrary to the direction of the maker and to his injury, with *full knowledge* on the part of the transferee of these facts, such instrument is void as to him." 87 Ga. App. at 513, 74 S.W.2d at 382. Perhaps this *is* what the court held. However, the financer was clearly trying to be a holder in due course of a note and if the breach of trust had been committed by the seller, the financer could, if a holder in due course, have enforced the instrument according to its tenor

against the buyer, even though he later found out about the fraud. Negotiable Instruments Law § 14. In sum, it is difficult to know what this case holds. It could be twisted into a holding against the finance company.

Idaho:

In *G.M.A.C. v. Garrard,* 41 Idaho 151, 238 Pac. 524 (1925), the buyer won because the tearing of the note from the contract constitutes a material alteration of the note. In *United States v. Troy-Parisian,* 115 F.2d 224 (9th Cir. 1940) financer recovered; however, the conditional sales contract contained a clause waiving defenses against assignees and this was held valid. So, although the financer asserted that it was a holder in due course, this argument was not considered by the court.

Illinois:

One should note first that Illinois has a statute that makes notes secured by chattel mortgages subject to any defenses that might be available against the mortgagee even though the note comes into the hands of a holder in due course. Ill. Rev. Stat. c. 95, § 26 (1933). Doubtless the chief effect of this statute is to discourage the use of chattel mortgages and to encourage the use of conditional sales contracts since they are not subject to the same regulations. See Warren, Tools of Chattel Security Transactions in Illinois, 1957 Ill. L. Forum 531, 544. Especially, perhaps, because Illinois recognizes as valid a clause in the conditional sales contract that waives against assignees of the contract defenses that might be good against the seller. *Commercial Credit Corp. v. Biagi,* 11 Ill. App. 2d 80, 136 N.E.2d 580 (1956). Otherwise, there does not seem to have been any consideration by the Illinois courts of the special problem of the financer as holder in due course. In the few cases I have found, the financer won. *Abingdon Bank & Trust Co. v. Shipplett-Moloney Co.,* 316 Ill. App. 79, 43 N.E.2d 857 (1942); *Woodlawn Security Finance Corp. v. Doyle,* 252 Ill. App. 68 (1929); *National Bond & Inv. Co. v. Lanners,* 253 Ill. App. 262 (1928); see also *Anderson Nat'l Bank v. Jacobson,* 305 Ill. App. 169, 27 N.E.2d 296 (1940) (rather special facts—the sale was of a horse and there were several renewals of the notes involved).

Indiana:

There are two cases, both involving the same financer, in which the buyer alleged that the financer was in the habit of buying the paper of a particular dealer—indeed, it was apparently the manufacturer of the items sold (oil burners). However, the chief argument seems to

have centered around the question of whether the financer *knew* of the defects in the equipment at the time it bought the notes. In both cases the financer won. *Berry v. Brandt C. Downey Co.*, 89 Ind. App. 545, 167 N.E. 136 (1929); *Dorbecker v. Brandt C. Downey Co.*, 88 Ind. App. 557, 163 N.E. 535 (1928). In one somewhat earlier case the financer lost, *Peoples State Bank v. Hall*, 83 Ind. App. 385, 148 N.E. 486 (1925). However, it lost only because the buyer averred that the seller's title to the note was "defective" because of fraud (Negotiable Instruments Law § 55) and hence the burden shifted to the financer to show that he was a holder in due course (Negotiable Instruments Law § 59) and he failed to satisfy this burden.

Iowa:

In *Associates Discount Corp. v. Goetzinger*, 245 Iowa 326, 62 N.W.2d 191 (1954) the financer lost on the ground that the seller was acting as its agent in procuring loans. It may well be that there was no closer relationship here than is usual between seller and financer. Doubtless the seller usually tries to talk the buyer into financing the sale through a particular financer. See also *Andrew v. Kolsrud*, 218 Iowa 15, 253 N.W. 913 (1934), where the buyer won on the same theory—he had paid the seller.

Kansas:

There is a decision in favor of the financer, *Atlas Acceptance Corp. v. Spurgeon*, 154 Kan. 290, 118 P.2d 535 (1941). However, no particular notice was taken of the peculiar status of the financer. *Stevens v. Vermillion*, 109 Kan. 504, 200 Pac. 277 (1921) is frequently cited for the financer, but there the court held there was no evidence of the asserted defense to the note. Hence there was no need to consider the holder in due course argument. There is also the rather special case of *Western Electric Co. v. Uhlrig*, 127 Kan. 261, 273 Pac. 417 (1929) where the seller was the financer's sales agent. The notes were given with an order of equipment to be supplied by the financer. The defense was that the equipment was never supplied—the buyer won. The buyer also won in *International Harvester Co. v. Watkins*, 127 Kan. 50, 272 Pac. 139 (1928) where (the facts are unclear) the financer lost because (1) the note was non-negotiable and (2) the seller was its agent. The financer was the manufacturer and its representatives were present in the room when the papers were signed. Indeed, they participated in preparing the papers. The financer won in *Advance-Rumely Thresher Co. v. West*, 108 Kan. 875, 196 Pac. 1061 (1921) on facts almost identical to those in *Advance-Rumely Thresher Co. v. Geyer*, 40 N.D. 18, 168 N.W. 731 (1918) in which the buyer won.

Kentucky:

I have found no really relevant cases in Kentucky. In *Remedial Plan v. Ott,* 199 Ky. 161, 250 S.W. 825 (1923) the buyer won. However, it was held that the note was not complete and regular on its face since it did not have a due date and it was not payable on demand. See also *Interstate Acceptance Corp. v. Humphress,* 309 Ky. 614, 218 S.W.2d 663 (1949) where a judgment for the buyer was reversed on the ground that there was evidence that financer was a holder in due course to go to the jury. There are a number of unusual facts, mostly arising out of the fact that the financer was floor planning the seller and this car was included in his lien.

Louisiana:

The situation in Louisiana is somewhat confused. There is an early supreme court case for the financer, *A. Marx & Sons v. N. Frey, Ltd.,* 137 La. 948, 69 So. 757 (1915). There are a number of subsequent courts of appeal decisions to the same effect: *Finance Security Co. v. Stuart,* 75 So. 2d 353 (La. App. 1954); *Super-Cold Southwest Co. v. Prunty,* 50 So. 2d 665 (La. App. 1951), aff'd, 220 La. 1053, 58 So. 2d 336 (1952); *White System, Inc. v. Hall,* 45 So. 2d 649 (La. App. 1950); *G.M.A.C. v. Swain,* 176 So. 636 (La. App. 1937) (though here the defense was usury to which it was said the financer was subject; however, there was no usury present); *G.M.A.C. v. Schoneke,* 19 La. App. 593, 140 So. 111 (1932); *General Contract Purchase Corp. v. Dillman,* 18 La. App. 286, 137 So. 654 (1931) (though here the buyer lost at the trial level and then abandoned his appeal); *Maloney v. Central Finance Co.,* 18 La. App. 108, 137 So. 353 (1931). However, there are also cases for the buyer. So, in *Stevens v. Gaude,* 9 La. App. 664, 120 So. 79 (1928) the court said that the sale of the note from seller to financer was a sham. See also *C.I.T. v. Emmons,* 197 So. 662 (La. App. 1940) (the item purchased was destroyed by fire; the buyer claimed the financer should have provided insurance, since an amount for insurance was included in the finance charge); *International Harvester Co. v. Carruth,* 23 So. 2d 473 (La. App. 1945) (seller considered financer's agent; financer manufacturer of items sold); *Citizens Loan Corp. v. Robbins,* 40 So. 2d 503 (La. App. 1949) (financer was the manufacturer of the goods); *Commercial Credit Corp. v. Freiler,* 42 So. 2d 296 (La. App. 1949) (note not complete and regular on its face since not completely filled in when received by financer); *G.M.A.C. v. Daigle,* 225 La. 123, 72 So. 2d 319 (1954) (defense was that car sold as new was used, the prior owner's purchase of the car was financed by financer). All the cases that hold for the financer have rather special facts except *International Harvester Co. v. Carruth* and *Citizens Loan Corp v. Robbins.* The latter

case was expressly disapproved in *White System, Inc. v. Hall.* However, both decisions were by courts of appeal (and not the supreme court) though of different circuits.

Maine:

I have found no cases in Maine.

Maryland:

In *Home Credit Co. v. Fouch,* 155 Md. 384, 142 Atl. 515 (1928) a new trial was awarded after a judgment for the buyer. There was a question about the financer's relation to the seller, although it was stated that knowledge of an executory contract would not prevent one from being a holder in due course. See also *United States v. Schaeffer,* 33 F. Supp. 547 (D. Md. 1940) where the financer was the manufacturer. The court felt that the transfer of the paper from seller to financer was ineffective to cut off defenses, but there was a question if there were any defenses. In *Cooke v. Real Estate Trust Co.,* 180 Md. 133, 22 A. 2d 554 (1941) the financer lost because, since it took assignment of both note and contract, it must look to the contract for its remedies. Here, the remedy, if the item sold (an oil burner) did not work, was to remove it. However, the situation in Maryland today is evidently governed to a large extent by a statute, Md. Ann. Code Gen. Laws art. 83, § 134 (1951), which provides that a note given as part of an installment agreement shall refer to the agreement and shall "in the hands of any subsequent holder" be subject to all defenses of the buyer except that acknowledgment of delivery by the buyer shall be conclusive to an assignee of the note without knowledge. This has been held to apply to holders in due course, *Griffin v. Baltimore Fed. Sav. and Loan Ass'n,* 204 Md. 154, 102 A.2d 804 (1954).

Massachusetts:

The financers won in the only relevant cases I have found: *Commercial Credit Co. v. M. McDonough Co.,* 238 Mass. 73, 130 N.E. 179 (1921); *Standard Acceptance Corp. v. Chapin,* 277 Mass. 278, 178 N.E. 538 (1931). No consideration was given to the financer-seller question.

Michigan:

The earlier Michigan cases seem to hold for the financer consistently. In the earliest case I have found the trial court found for the buyer on the ground that the financer was estopped to deny that the seller was its agent, but this decision was reversed on appeal. *Republic Mortgage Co. v. Johnson,* 221 Mich. 97, 190 N.W. 628 (1922). Otherwise the financer won. *Muskegon Citizens Loan & Inv. Co. v.*

Champayne, 257 Mich. 427, 241 N.W. 135 (1932); *Northwestern Finance Co. v. Crouch,* 258 Mich. 411, 242 N.W. 771 (1932); *Manufacturers' Finance Corp. v. Estate of Andary,* 269 Mich. 1, 256 N.W. 601 (1934); *United States v. O'Hara,* 46 F. Supp. 780 (E.D. Mich. 1942); *Hardy v. C.I.T.,* 308 Mich. 256, 13 N.W.2d 281 (1944). However, in *Allied Bldg. Credits, Inc. v. Mathewson,* 335 Mich. 270, 55 N.W.2d 826 (1952) the buyer won. This was upheld on the ground that there was sufficient evidence of "notice" so that issue of whether the financer was a holder in due course could properly go to the jury. The buyer claimed that the relationship between seller and financer was so close that the seller was a branch of the financer. The court said: "We decline without further proof to find the intimate relationship between the 2 companies as claimed by defendant. We do, however, hold with the trial judge that there was sufficient proof of notice to the plaintiff so that it became a jury question whether plaintiff was a holder in due course without notice." Id. at 274, 55 N.W.2d at 828. The court then proceeded to discuss briefly several aspects of the testimony and concluded the case was a close one on the facts. I cannot determine whether the financer and seller relationship was one of the relevant facts on the issue of the financer's being a holder in due course or not. Apparently it was not, but it is hard to say definitely. A subsequent federal case is *United States v. Roberts,* 115 F. Supp. 786 (E.D. Mich. 1953) in which the buyer won because the application for the loan (for housing improvements) was made to the financer, and further that the financer was familiar with these transactions and knew it should not discount the loan without receiving a completion certificate signed by the buyer (under FHA regulations).

Minnesota:

First & Lumberman's Nat'l Bank v. Buchholz, 220 Minn. 97, 18 N.W.2d 771 (1945) is the only relevant case I have found. It held that it was possible that when the financer became assignee of both conditional sales contract and note, before the consideration had passed, "he takes such note with notice of a condition to liability on the instrument and is prevented from becoming a holder in due course." Id. at 102, 18 N.W.2d at 774. Hence, he was subject to the defense of breach of warranty. The case purported to apply Wisconsin law, not that of Minnesota. However, see the discussion of *Implement Credit Corp. v. Elsinger,* under Wisconsin. See also *State Bank v. Lovrenz,* 163 Minn. 18, 203 N.W. 427 (1925) where financer-plaintiff was an auctioneer for seller and took notes for sows purchased by buyer, knowing of a warranty. He was held to be a holder in due course and hence free of defense of breach of warranty.

Mississippi:

I have found no case in Mississippi that treats the question explicitly. However, in cases involving the basic fact situation, the financer won. See for example, *Roberts v. International Harvester Co.,* 181 Miss. 440, 179 So. 745, motion for new trial and modified judgment overruled (assertion of agency), ibid., 180 So. 747 (1938); *Universal Credit Co. v. Moore,* 173 Miss. 740, 163 So. 142 (1935); *General Contract Corp. v. Leggett,* 224 Miss. 262, 79 So. 2d 843 (1955) (no implied agency for seller to collect despite close operating relationship).

Missouri:

Another of the "leading cases" against the finance company is *Taylor v. Atlas Security Co.,* 213 Mo. App. 282, 249 S.W. 746 (1923). However, the facts are fairly extreme: the buyer and his wife were uneducated negroes—the husband could not read—who were defrauded by the seller; the note was payable to the financer. The relations between seller and financer were unusually close. There were strong indicates of *actual* knowledge by the financer of the fraud. There are, moreover, subsequent cases, perhaps more typical, in which the financer won. *Morgan v. Mulcahey,* 298 S.W. 242 (Mo. App. 1927); *Hunt v. Dean,* 72 S.W.2d 831 (Mo. App. 1934); *Local Finance Co. v. Charlton,* 289 S.W.2d 157 (Mo. App. 1956); *Gale and Co. v. Medley,* 289 S.W.2d 460 (Mo. App. 1956). However, there is another subsequent Missouri case in which the financer lost, either on the ground that there was an installment overdue when it purchased or because the financer did not prove that it *was* a holder in due course (presumably because it had the burden to do so under Negotiable Instruments Law § 59, although the point is not made clear). *Progressive Finance and Realty Co. v. Stempel,* 231 Mo. App. 721, 95 S.W.2d 834 (1936).

Montana:

The particular fact situation exists but is not discussed and the financer won in *Baker State Bank v. Grant,* 54 Mont. 7, 166 Pac. 27 (1917) (the only case I found).

Nebraska:

A relatively early case, *First Nat'l Bank v. Newton,* 119 Neb. 394, 229 N.W. 334 (1930), held for the financer. However, in *Von Nordheim v. Cornelius,* 129 Neb. 719, 262 N.W. 832 (1935) the buyer won because the defense was want of consideration and the note and security device (referred to by the court both as a mortgage and as a conditional sales contract), being attached and assigned together, the

note may be rendered non-negotiable. Or, the financer was charged with notice of the terms of the contract including the consideration that was to be furnished. Hence (?) he was not a holder in due course. (I am not clear on the basis of the decision.) In any event, he took the note subject to defenses.

Nevada:

I have found no cases in Nevada.

New Hampshire:

Financer won in *Franklin Discount Co. v. Murphy,* 98 N.H. 31, 93 A.2d 669 (1953). However, there is no discussion of the points at issue here.

New Jersey:

In one early case the financer lost when he brought replevin when there was a defense under a conditional sales contract, *Auto Brokerage Co. v. Ullrich,* 102 N.J.L. 341, 131 Atl. 901 (1926), but won when he sued on the note, *Auto Brokerage Co. v. Ullrich,* 4 N.J. Misc. 808, 134 Atl. 885 (1926). Similarly in a later case the financer (its assignee, really) lost in an action against the buyer because it did not follow the procedure outlined in the Uniform Conditional Sales Act in selling the property; hence, the buyer was discharged. *Veterans Loan Authority v. Rozella,* 21 N.J. Super. 1, 90 A.2d 505 (1952). I have found no other case in which the buyer won. In *Mutual Finance Corp. v. Dickerson,* 123 N.J.L. 62, 7 A.2d 859 (1939) the relation between financer and seller was spelt out in considerable detail. However, the financer won. See also *B.A.C. Corp. v. Circucci,* 131 N.J.L. 93, 35 A.2d 36 (1944) and *Eastern Acceptance Corp. v. Kavlick,* 10 N.J. Super. 253, 77 A.2d 49 (1950) where the financer also won.

New Mexico:

The buyer won in the only case I have found, *State Nat'l Bank v. Cantrell,* 47 N.M. 389, 143 P.2d 592 (1943) because, since he was assignee of the contract as well, he had to assume its burdens (defense of failure of consideration) as well as its benefits. This point is annotated in 152 A.L.R. 1216-22 (1944).

New York:

There are cases in New York for almost every conceivable position. However, I have found no case in the Court of Appeals and, consequently, one is even less able to say what "the law" is here than one usually is. Many cases hold for the financer. Thus, for example, *Petroleum Acceptance Corp. v. Queen Anne Laundry Service,* 38 N.Y.S.

2d 675 (Sup. Ct. 1942); *Credit Alliance Corp. v. Buffalo Linen Supply Co.*, 238 App. Div. 18, 263 N.Y. Supp. 39 (4th Dep't 1933); *Commercial Credit Corp. v. Smith,* 143 Misc. 478, 256 N.Y. Supp. 759 (1932); *United States v. Novsam Realty Co.*, 125 F.2d 456 (2d Cir. 1942). Those which hold for the buyer usually do so on the ground that the note and conditional sales contract must be considered as one document and defenses good against the assignee of the contract are good against the endorsee of the note. Thus, *Colonial Discount Co. v. Rumens,* 249 App. Div. 736, 291 N.Y. Supp. 676 (2d Dep't 1936), aff'd, 274 N.Y. 612, 10 N.E.2d 576 (1937); *C.I.T. v. Joffe,* 157 Misc. 225, 283 N.Y. Supp. 881 (1935), rev'd on other grounds, 162 Misc. 328, 293 N.Y. Supp. 659 (1937); *Federal Credit Bureau, Inc. v. Zelkor Dining Car Corp.*, 238 App. Div. 379, 266 N.Y. Supp. 920 (1st Dep't 1933); *Heiman v. Murphy,* 143 Misc. 81, 256 N.Y. Supp. 20 (1932). One municipal court case held for the buyer on the ground that the financer-seller relation was in fact a joint enterprise, *Buffalo Industrial Bank v. De Marzio,* 162 Misc. 742, 296 N.Y. Supp. 783 (1937), rev'd on other grounds, 6 N.Y.S.2d 568 (Sup. Ct. 1937). In a case in which the note was given for a furnace to be installed under an FHA insured loan, the financer was said not to be a holder in due course since it took an assignment of the note without insisting on all the documents it knew the FHA required, *Lincoln Nat'l Bank & Trust Co. v. Marsh,* 24 N.Y.S.2d 281 (Sup. Ct. 1940). See also *United States v. Hansett,* 30 F. Supp. 455 (E.D.N.Y. 1939).

North Carolina:

There are two recent decisions for the buyer. In *Whitfield v. Carolina Housing & Mortgage Corp.*, 243 N.C. 658, 92 S.E.2d 78 (1956) the court held that the financer was not a holder in due course because of its close relation to the seller though its reasoning in not spelt out. In *Wachovia Bank & Trust Co. v. Currin,* 244 N.C. 120, 92 S.E.2d 658 (1956) the court held inter alia that a fairly typical financer was not a holder in due course, and was thus subject to defenses.

North Dakota:

Advance-Rumely Threshing Co. v. Geyer, 40 N.D. 18, 168 N.W. 731 (1918) holds for the buyer on somewhat unusual facts. The plaintiff holder of the note was formed to take over the assets of the manufacturing company. The note was given to a distributing company which paid for goods from the manufacturing company with its customers' notes. It had so transferred the note in suit. The court declared the plaintiff was in the shoes of the manufacturing company and the manufacturing company and the distributing company were

in fact one concern despite the fiction of corporate separation. This the court would look through. The Kansas court in *Advance-Rumely Thresher Co. v. West* refused to do this.

Ohio:

There are Ohio cases in which the financer won since he did not know of the defense at the time the note was negotiated to him and was otherwise a holder in due course. There was no discussion of the relationship, if any. *Anchor Loan Co. v. Willett,* 137 N.E.2d 532 (Ohio C.P. 1956) ; *National City Bank v. Erskine & Son,* 65 Ohio L. Abs. 51, 110 N.E.2d 593 (1951) ; 158 Ohio St. 450, 110 N.E.2d 598 (1953) ; *Motor Finance Corp. v. Huntsberger,* 116 Ohio St. 317, 156 N.E. 111 (1927). However, in *McCurdy v. Stevens,* 30 Ohio App. 545, 165 N.E. 855 (1928), the court held that the financer was either an interested party or a medium through which the financer-manufacturer sought to escape liability. See also *Bank v. Wendel,* 100 Ohio St. 47, 125 N.E. 111 (1919), where the buyer won though the facts are a little unusual perhaps. In *Davis v. Commercial Credit Corp.,* 87 Ohio App. 311, 94 N.E.2d 710 (1950), a judgment for the buyer against the financer and seller for fraud was affirmed. This was chiefly because the financer had actual knowledge of the seller's fraud. In pointing out the facts that indicated this, the court mentioned, id. at 316, 94 N.E.2d at 713, that the financer had furnished the seller "with the printed forms, which were long documents containing credit statements, promissory notes and completion statements . . . ." It also cited the Arkansas case of *Commercial Credit Co. v. Childs.*

Oklahoma:

In *Mayer v. American Finance Corp.,* 172 Okla. 419, 45 P.2d 497 (1935) the financer won and it was pointed out that the fact that the financer had furnished the seller with printed forms providing for the assignment back to the financer did not make the seller the financer's agent. In that case the security device was a chattel mortgage and the action was replevin. In an earlier case the financer, as the assignee of a note and conditional sales contract, was held subject to the defenses of the buyer because it was asserting its rights under the contract by bringing replevin. However, there were no defenses proved. *Mercantile Trust Co. v. Roland,* 143 Okla. 190, 288 Pac. 300 (1930).

Oregon:

I have found no cases in Oregon. *Albany State Bank v. Anthony,* 121 Ore. 277, 254 Pac. 806 (1927) held that a note that included all of the terms of a conditional sales contract was non-negotiable.

Pennsylvania:

In general the few Pennsylvania cases that I have found seem to go for the financer without much difficulty. *Fried v. Feola,* 129 F. Supp. 699 (W.D. Pa. 1954); *First Nat'l Bank v. Hartman Co.,* 147 Pa. 396, 24 A.2d 582 (1942); *Commercial Credit Corp. v. Kozokas,* 37 Luzerne L. Reg. 399 (Pa. C.P. 1941); *International Finance Co. v. Magilansky,* 105 Pa. Super. 309, 161 Atl. 613 (1932). However, in *Sisemore & Kierbow Co. v. Nicholas,* 149 Pa. Super. 376, 27 A.2d 473 (1942), the seller was held to be the financer's selling agent. Hence, the financer was not a holder in due course. Though the situation is a little different from the usual one since the purported financer was the manufacturer of the goods, the court's list of factors that showed the financer's connection with the transaction is typical of most of these arrangements. See also *Ubaldini v. C.I.T.,* 122 Pa. Super. 428, 186 Atl. 198 (1936), where buyer paid seller after assignment to financer, and payment was a defense against financer. At the present time, in addition to the Uniform Commercial Code, there is a statute in Pennsylvania which provides that no installment sale for a motor vehicle "shall require or entail the execution of any note or series of notes by the buyer, which when separately negotiated, will cut off, as to third parties, any right of action or defense which the buyer may have against the original seller." Pa. Stat. Ann. tit. 69, § 615 (Purdon Supp. 1957).

Rhode Island:

In an action by the buyer against the seller for breach of warranty, it was held proper to include as an item of damage a note paid to the financer after repudiation by the buyer of the contract. The bank became a holder in due course before notice of the breach and hence was entitled to be paid regardless of a breach of warranty. Thus, it was no waiver of the breach of warranty against the seller by the buyer to pay this installment to the financer. *Swartz v. Edwards Motor Car Co.,* 49 R.I. 18, 139 Atl. 466 (1927).

South Carolina:

The financer won in *Continental Illinois Nat'l Bank & Trust Co. v. Hendrix Co.,* 186 S.C. 268, 195 S.E. 562 (1938); see *Carolina Housing & Mortgage Corp. v. Reynolds,* 96 S.E.2d 485 (S.C. 1957). But see *Bank of Commerce v. Waters,* 215 S.C. 543, 56 S.E.2d 350 (1949), where a combination note and conditional sales contract was held non-negotiable

South Dakota:

Apparently in South Dakota if the financer attempts to enforce, or is even the assignee, of a conditional sales contract as well as of a

note, he is subject to defenses that are available against the seller. *General Electric Contract Corp. v. Heimstra,* 69 S.D. 78, 6 N.W.2d 445 (1942); *C.I.T. v. Wesling,* 53 S.D. 337, 220 N.W. 855 (1928). However, see *Fischer v. Timber Lake Supply Co.,* 61 S.D. 15, 246 N.W. 97 (1932), in which the financer was held to be a holder in due course of the note and hence not bound by a special agreement about payment between buyer and seller that was not contained in the conditional sales contract. Otherwise the question does not seem to have been considered.

Tennessee:

In *Third Nat'l Bank v. Keathley,* 35 Tenn. App. 82, 242 S.W.2d 760 (1951) the financer won. The financer had regular dealings with the seller and normally relied on his word as to the credit standing of the buyer. However, in *Wright v. Batchelor Motor Co.,* 2 Tenn. App. 468 (1926) where the question is what rights to resale the assignee of a conditional sales contract got, the court said that he succeeded to the benefits *"and burdens"* of the original seller. But see *Nabors v. Hamilton Trust & Savings Bank,* 2 Tenn. App. 523 (1926) where the financer won in an action on a note.

Texas:

No case has been found in Texas in which the financer lost because he was a financer. On the other hand, no case has been found in which the business relationship was considered except where the defense was usury, and in Texas a usurious note is void even in the hands of a holder in due course. See *National Bond & Investment Co. v. Atkinson,* 254 S.W.2d 885 (Tex. Civ. App. 1952); *Continental Nat'l Bank v. Conner,* 147 Tex. 218, 214 S.W.2d 928 (1948). There are cases where the financer won. *Intges v. People's Finance & Thrift Co.,* 44 S.W.2d 1028 (Tex. Civ. App. 1931); *International Harvester Co. v. Newberry,* 16 S.W.2d 871 (Tex. Civ. App. 1929); *C. H. Mountjoy Parts Co. v. San Antonio Nat'l Bank,* 12 S.W.2d 609 (Tex. Civ. App. 1928); *Scrivner v. Federal Credit Bureau,* 12 S.W.2d 592 (Tex. Civ. App. 1928); *Harty v. Keokuk Savings Bank,* 201 S.W. 419 (Tex. Civ. App. 1918). Where the purported financer was the manufacturer, it lost, as it did when through its close continuing relation with the financer, it was held to know the seller was doing business in Texas though not qualified and that the seller had given a warranty that might be breached. *International Harvester Co. v. Newberry,* 16 S.W.2d 871 (Tex. Civ. App. 1929); *Southern Discount Co. v. Rose,* 290 S.W. 861 (Tex. Civ. App. 1927). Financers have also lost on the ground that since they were assigned the conditional sales contract as well as the note, they took with notice that the consideration might

fail (as it did). *Sloan Lumber Co. v. Ambrose,* 26 S.W. 2d 348 (Tex. Civ. App. 1930). In another case, the financer required a "completion certificate" (indicating that the work had been done) before it would accept paper from the seller. It furnished the forms. All of this made the financer an "original party" to the transaction and not a holder in due course. *Allied Building Credits, Inc. v. Ellis,* 258 S.W.2d 165 (Tex. Civ. App. 1953).

Utah:

I have found no cases in Utah, though the clause in a sales contract waiving defenses against assignees was upheld in *Anglo-California Trust Co. v. Hall,* 61 Utah 223, 211 Pac. 991 (1922).

Washington:

No very relevant case has been found. The buyer won in *Vancouver Nat'l Bank v. Starr,* 123 Wash. 58, 211 Pac. 746 (1923) because the note was held non-negotiable owing to additional promises. In *Yakima Finance Corp. v. Mullins,* 138 Wash. 699, 245 Pac. 5 (1926) the financer knew that the seller had planned to have the last (and largest) of a group of notes given for an automobile paid by legal services to be rendered by the buyer to the seller. This did not prevent it from being a holder in due course which could recover from the buyer.

West Virginia:

Commercial Credit Co. v. Barnett, 116 W. Va. 132, 178 S.E. 816 (1935) holds for the financer. The financer negotiated for some time with the seller to get him to put the documents in such shape that it would buy them. It was dissatified with the buyer's credit rating and wanted accommodation endorsers.

Wisconsin:

Implement Credit Corp. v. Elsinger, 268 Wis. 143, 66 N.W.2d 657 (1954) is one of the few cases that goes into the relationship between financer and seller in considerable detail and yet holds for the seller. See also *Shawano Finance Corp. v. Julius,* 214 Wis. 637. 254 N.W. 355 (1934) where the financer won although the financer-seller relationship is not considered. The Minnesota court, in applying Wisconsin law, in *First & Lumberman's Nat'l Bank v. Buchholz,* would appear to be contra. At any rate it reached the opposite result.

Wyoming:

Financer won in *People's Finance & Thrift Co. v. De Berry,* 50 Wyo. 301, 62 P.2d 307 (1936).

WASHINGTON UNIVERSITY
LAW QUARTERLY

Member, National Conference of Law Reviews

Volume 1958 April, 1958 Number 2

Edited by the Undergraduates of Washington University School of Law, St. Louis.
Published in February, April, June, and December at
Washington University, St. Louis, Mo.

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