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Bills and Notes -- Intentional Cancellation of Instrument as Discharge of Obligation

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NOTES AND COMMENTS

Bills and Notes—Intentional Cancellation of Instrument as Discharge of Obligation

H bought sixteen bonds of a series issued by defendants in 1912. In 1939, after the bonds had long been in default as to both principal and interest, *H* was advised by her financial agent, the plaintiff here, that they were worthless and she then burned them. When, ten years later, defendants were undergoing bankruptcy proceedings for reorganization, the plaintiff realized that the bonds were not without value and tried to recover as *H's* conservator. *Held:* There could be no recovery because the destruction of the instruments was intentional, and therefore the obligation was discharged.[1]

In reaching this decision the United States Court of Appeals for the Tenth Circuit gives the strictest possible interpretation to the language of the controlling Oklahoma statute which reads: "A negotiable instrument is discharged . . . (3) By the intentional cancellation thereof by the holder;"[2] which wording is identical with that of the Uniform Negotiable Instruments Law.[3]

The question squarely presented here is: In order to effect a discharge of the obligation itself, does the "intentional cancellation" referred to by the statute, require that only the *act* of destroying the instrument be intentional, or must there also be a further intent to renounce all rights under the debt?

The cases which have dealt with this problem, both before and since the Uniform Negotiable Instruments Law was enacted, apparently leave the matter still unsettled.

Only one case is found expressly construing the wording of the statute, which decision was relied on in the principal case.[4] There the payee of the note "made away with it," and although there was some

[1] State Street Trust Co. v. Muskogie Electric Trust Co., 204 F. 2d 920 (10th Cir. 1953). If by being in default the court means the bonds had matured, it would appear this action brought over ten years later would be barred by Oklahoma's five year statute of limitations. OKLA. STAT. ANN. tit. 12, § 95(1) (1937). It would make no difference that the bonds might be under seal for Oklahoma has abolished all distinctions between sealed and unsealed instruments. OKLA. STAT. ANN. tit. 15, § 139 (1937).

[2] OKLA. STAT. ANN. tit. 48, § 95(3) (1937).

[3] NEGOTIABLE INSTRUMENTS LAW § 119(3), found at N. C. GEN. STAT. § 25-126 (1953). THE UNIFORM COMMERCIAL CODE § 3-605 changes the language slightly: "(1) The holder of an instrument may even without consideration discharge any party (a) by intentionally cancelling the instrument or the party's signature by destruction or mutilation."

[4] McDonald v. Loomis et al., 233 Mich. 174, 206 N.W. 348 (1925).

showing of intent to forgive the debt by the destruction of the note, the court ruled that under the statute there is no need for a showing of intent beyond that simply to destroy the instrument. The court reasoned this to be the best rule, for if a holder who intentionally destroyed the primary evidence of his debt were allowed to still maintain an action, endless frauds would be invited for the courts to test.[5]

In the other decisions wherein it has been found that an intentional cancellation of the instrument is effective as a discharge of the debt, there was also present the further intent to actually forgive the obligation itself.[6]

There is, however, a group of cases in which no intent could be shown beyond that to destroy the instrument, and no cancellation of the obligation was found. Thus, it was held that where the parties to the note agreed to cancel it, but also expressly agreed that the debt was to remain in existence, the destruction of the note did not work a cancellation of the debt for the reason that the parties did not intend it to so operate.[7] The same result was reached where it was held to be a question for the jury to determine whether a note was torn with intent to relinquish the right to collect the money, even though it was intentionally destroyed during a fit of anger following a quarrel.[8] Again, it was held to be no discharge of the debt when the payee-wife intentionally tore her note after a quarrel with the maker-husband.[9] The rule announced by these cases would seem to be that though the

[5] *Id.* at 184, 206 N.W. at 351, relying on Vanauken v. Hornbeck, 14 N. J. Law 178 (Sup. Ct. 1833), wherein plaintiff, in anger, burned a note. It was held that there can be no action on the note for it ". . . would open a door to frauds without number—there may be memorandums, indorsements, attesting witnesses, or matters apparent on the face of the instrument, very important to the rights of the other party; and to get rid of which, may be the motive for carelessness or destruction." 14 N. J. Law 178, 182 (Sup. Ct. 1833).

[6] Darland v. Taylor, 52 Iowa 503, 3 N.W. 510 (1879) (destruction of note to forgive maker of obligation itself); Norton v. Smith, 130 Me. 58, 153 Atl. 886 (1931) (same); Wilkins v. Skoglund, 127 Neb. 589, 256 N.W. 31 (1934) (father gave a car to son A, and wanting to make a similar gift to son B, destroyed a note payable to him by B); Henson v. Henson, 151 Tenn. 137, 268 S.W. 378 (1925) (destruction of note to forgive obligation); *accord,* Jones' Adm'rs v. Coleman, 121 Va. 86, 92 S.E. 910 (1917) (no explanation offered for destruction of the note, but it was presumed that the burning was intentional and done to cancel the instrument).

[7] Gardner v. Rutherford, 57 Cal. App. 2d 874, 136 P. 2d 48 (1943).

[8] Greene v. Doz, 182 N. Y. Supp. 900 (Sup. Ct. 1920).

[9] Schlemmer v. Schendorf, 20 Ind. App. 447, 49 N.E. 968 (1898). The court here relied on Riggs v. Tayloe, 9 Wheat. 483 (U. S. 1824), where it was held there would be an action if the destruction, "even though voluntary" (intentional?), occurs through some mistake, and on Bagley v. McMickle, 9 Cal. 430 (1858), where it was held that if the plaintiff's claim be free from all suspicion of fraud, then the motive for the destruction becomes controlling as to whether or not secondary evidence will be admitted to prove the existence of the debt. *Accord,* Cockell v. Cawthon, 110 S.W. 2d 636 (Texas 1937), where although dealing with renunciation, the court ruled that even though the payee delivered a release as well as the notes themselves to the maker, if the payee did not intend to thereby effect a renunciation, the court would find none.

destruction of the instrument be an intentional act, if there be no intent thereby to discharge the obligation itself, and if clearly no circumstances are present which raise a suspicion of fraud, then the plaintiff ought to be allowed his action.[10] It should be noted that in these cases which have held the destruction of the instrument to be no discharge of the obligation, the action apparently was on the instrument, nothing being said as to whether or not any action remained on the original debt.[11]

It would seem that this distinction could validly be made, for when dealing with a material alteration of an instrument the courts look to see if the alteration was fraudulently made, and if it was not, then though the *instrument* is cancelled, there still exists an action on the original debt.[12] Were this principle extended to cases involving destruction, it would seem that so long as there are no circumstances suggesting fraud, and there is no intent to cancel the obligation, the court could find that the *instrument* is cancelled, but still allow the holder to sue on the obligation itself.

A somewhat analogous situation to destruction of an instrument is presented when the holder of a note or check marks it "Paid," thereby ostensibly discharging the instrument,[13] and later discovers it to be actually unpaid. Thus, where a partial payment only was made and the holder marked the note "Paid," the court found the holder still had an action.[14] In this area the courts are apparently willing to find that the obligation is not discharged on the ground that the holder usually is acting under some mistake.[15] The Uniform

[10] Blade v. Noland, 12 Wend. 173 (N. Y. 1834). Here no explanation was given for the destruction of the note. However, strong language is used by the court indicating that had there been evidence refuting any suspicion of fraud, an action could have been maintained, but in the absence of such evidence the court would not presume an honest purpose.

[11] However, in Greene v. Doz, *supra* note 8, the court, referring to an intent "to give up the right to collect the moneys represented by the notes," possibly implied that had there been present no intent to discharge the obligation, there would be an action on the original debt. This distinction, of course does not concern us when the court, as in the principal case, says the destruction of the instrument is also a discharge of the debt.

[12] Born v. Lafayette Auto Co., 196 Ind. 399, 145 N.E. 833 (1924); Perry v. Mfg. Nat. Bank of Lynn, 305 Mass. 368, 25 N.E. 2d 730 (1940); Catching v. Ruby, 91 Ore. 506, 178 Pac. 796 (1919).

[13] Washington Loan & Trust Co. v. Colby et al., 108 F. 2d 743 (D. C. Cir. 1939), relying on District of Columbia v. Cornell, 130 U. S. 655, 658 (1888), wherein it was said: "It is immaterial whether the cancellation is by destroying the instrument, or by writing or stamping words or lines in ink upon its face, provided the instrument . . . unequivocally shows that it has been cancelled."

[14] First Nat. Bank of Vicksburg v. Drexler, 184 So. 607 (La. 1938).

[15] Banks v. Marshall, 23 Cal. 223 (1863) (Where plaintiff received less interest than the note called for, but surrendered the note to the maker thinking it was fully paid, it was held that an action still existed on the note.); Drake Lumber Co. v. Semple, 100 Fla. 1757, 130 So. 577 (1930) (Bank thought the maker was paying his note and marked it paid. Actually the maker was buying the note as an assignee's agent. No discharge was found as none of the parties intended such.); Manufacturer's National Bank v. Thompson, 129 Mass. 438

Negotiable Instruments Law expressly provides that the cancellation is inoperative when made by mistake,[16] but the analogy remains in that just as in the principal case the holder intended to destroy the bonds, so in the case of the note or check the holder intended to mark the particular instrument "Paid."

The plaintiff here attempted to show that the bonds were destroyed through mistake, but the court found only an error in judgment not protected by the statute.[17] The mistake in the check and note cases, where relief was granted, consisted of the holder erroneously thinking the maker *had* money, while in the principal case, the holder thought the defendants would have *no* money. When the holder destroyed the bonds the defendants did not have the money to pay, but in time they acquired some funds. Obviously the plaintiff was mistaken as to the skill of the defendants' financial manager and as to the economic conditions surrounding the defendants' return to solvency. It is only questioned whether, under such circumstances, to conclude that a maker will have no funds in the future, is any less a mistake than to conclude the maker now has funds available, when both conclusions prove to be wrong.

In examining the reasoning of the court in the principal case, we find language which seems to question the court's own ruling. While the court concludes that it is unnecessary to find an intent to forgive the obligation, it reasons that the act of destruction is the highest

(1880) (Plaintiff, thinking maker of note had funds available, marked the note paid but the maker did not have funds. An action was found to exist.); Gleason v. Brown, 129 Wash. 196, 224 Pac. 930 (1924) (Payee cashed a check after maker's death. Upon advice he restored the money to the estate, and the court held that the payee still had an action as the cancellation occurred through a mistake of law.)

To the same effect are Prince v. Oriental Bank Corp., Eng., 3 App. Cas. 325 (1878); Warwick v. Rogers, Eng., 5 Man. & G. 340, 134 Eng. R. 595 (1843); Raper v. Birkbeck, Eng., 15 East 17, 104 Eng. R. 750 (1812); Ward v. Wray, Can., 23 Ont. W.N. 710, 9 Dom. L.R. 2 (1913).

North Carolina reaches the same result in Dewey v. Bowers, 26 N. C. 538 (1844). There defendant paid his note with a draft. Several days later, thinking the draft had been paid, plaintiff surrendered the note to defendant. No discharge was found, the court looking to the intent of the parties. *But cf.* Hood System Industrial Bank of High Point v. Dixie Oil Co., 205 N. C. 778, 172 S.E. 360 (1934).

Contra: Broad and Market Nat. Bank v. N. Y. & E. R. Co., 102 Misc. Rep. 82, 168 N. Y. Supp. 149 (Sup. Ct. 1917) (Plaintiff, thinking defendant had funds available, accepted his check in payment of a note and marked the note paid. A good discharge was found in that there was no fraud or mistake. However, the court recognized the discharge would have been inoperative had the check been accepted only on condition that it had to be honored before payment was valid.)

[16] NEGOTIABLE INSTRUMENTS LAW § 123, found at N. C. GEN. STAT. § 25-130 (1953). "A cancellation made unintentionally, or under a mistake or without the authority of the holder, is inoperative. . . ."

[17] State Street Trust Co. v. Muskogie Electric Trust Co., 204 F. 2d 920, 923 (10th Cir. 1953).

evidence of such an intent.[18] Had the court chosen to follow this line of reasoning, there seems little doubt that the plaintiff would have recovered, for the court admits there was *no* intent present to forgive the debt itself. However, the court simply chooses to conclude that regardless of the holder's over-all intent, so long as he intentionally destroyed the instrument, the whole obligation is forgiven.

It would seem that under this strict interpretation of the statute, even where the parties agreed to destroy the instrument but also expressly agreed that the debt should remain in existence, a discharge of the obligation would nevertheless result because only the act of destruction is looked to, and if that be intentional, the debt is discharged. It would further seem that even if a clear mistake of law or fact were present, this rule would compel the discharge to be effective if the act of cancelling the note is intentional, flying directly in the face of the section of the statute that provides the discharge shall be inoperative if made through mistake.[19] Surely the court would not intend to sanction such a result.

It is seriously questioned whether such a narrow interpretation is desirable. The results indeed appear harsh. The maker has done nothing in reliance on the destruction—in fact he was even ignorant of the act. Therefore he would be done no harm had the court simply said he was still liable. Whereas, by saying his liability was at an end, the effect is to make a gift to him, while the holder certainly did not intend to make a gift. The holder simply thought he would be unable to collect the debt, and from this the court's conclusion in effect would say that because he knowingly destroyed the instrument, he no longer wanted to collect the debt. It is felt that justice would best be served if, in each case, we were to look behind the destruction to discover the true motive for it, rather than to apply the automatic rule of absolute discharge announced here.

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Bills and Notes—Renunciation of Rights by Holder Conditioned Upon Holder's Death—Effect as Discharge of Parties Liable on Instrument

"There is some obscurity in the provisions of our statute," said a New York court in its decision of a 1905 case[1] which hinged on the interpretation of a section of the statute on negotiable instruments then in force in that state[2]—a section virtually identical with the present Section 122 of the Negotiable Instruments Law.[3] A recent Virginia

[18] *Id.* at 922.

[19] See note 16 *supra.*

[1] Leask *et al.* v. Dew, 102 App. Div. 529, 92 N. Y. S. 891 (1st Dep't 1905).
[2] N. Y. Laws 1897, c. 612, § 203.
[3] "The holder may expressly renounce his rights against any party to the