



---

Volume 66 | Issue 1

Article 12

---

December 1963

# Negotiable Instruments--Defense Available Against Holder in Due Course

John Ralph Lukens

*West Virginia University College of Law*

Follow this and additional works at: <https://researchrepository.wvu.edu/wvlr>

 Part of the [Banking and Finance Law Commons](#), and the [Torts Commons](#)

---

## Recommended Citation

John R. Lukens, *Negotiable Instruments--Defense Available Against Holder in Due Course*, 66 W. Va. L. Rev. (1963).

Available at: <https://researchrepository.wvu.edu/wvlr/vol66/iss1/12>

This Case Comment is brought to you for free and open access by the WVU College of Law at The Research Repository @ WVU. It has been accepted for inclusion in West Virginia Law Review by an authorized editor of The Research Repository @ WVU. For more information, please contact [ian.harmon@mail.wvu.edu](mailto:ian.harmon@mail.wvu.edu).

within which an act is to be done shall be computed by excluding the first day and including the last . . .” By applying this statute, March 9 would have been only the fifty-ninth day of the session meaning that the act was passed well within the deadline. Most authorities would seem to prefer this interpretation. 38 L.R.A.(N.S.) 1161 (1912). The court resolved the question by holding the statute inapplicable since concern was not with the “time within which an act is to be done,” but with the constitutional requirement that the regular session “shall not exceed sixty days.” The constitution makes no mention of excluding the first day from the count.

The journal of the House of Delegates for March 9, 1963 discloses that the House acted upon several other bills after the vote on the now void “Blue Law” bill. Two existing statutes were amended and re-enacted, one concerning boundary changes of cities, towns, and villages. W. VA. CODE ch. 8, art. 2, § 8 (Michie Supp. 1963). The other dealt with warning and identification lights on school buses. W. VA. CODE ch. 17C, art. 12, §§ 7-8 (Michie Supp. 1963). The parties to any litigation involving these acts must consider the court’s decision nullifying a bill passed earlier in time on the same day.

The holding in the principal case would suggest that the validity of any West Virginia statute could be questioned should the journals of either house disclose that some constitutional requirement was not met at the time of enactment.

*Victor Alfred Barone*

---

### **Negotiable Instruments—Defenses Available Against Holder in Due Course**

*D*, the innocent purchaser of a stolen automobile, gave a note to the seller in the amount of 2270 dollars and executed a chattel mortgage as security for the note. The purchasing agreement signed by *D* stated *D* would pay the note irrespective of any imperfection in the chattel. The seller endorsed the note and transferred it and the mortgage to *D*-bank. The insurer of the true owner of the automobile instituted an action against *D* and *D*-bank to obtain the automobile. *D* and *D*-bank filed cross claims against one another. The trial court found that *D*-bank was a holder in due

course of the note and that *D* was liable for the unpaid balance thereon, but that *D* was entitled to set off the value of the automobile. Judgment of six dollars was entered in favor of *D*-bank. *Held*, reversed. *D* was not entitled to set off the value of the automobile. Though *D*-bank could not use the chattel mortgage to satisfy its claim, a holder in due course of a negotiable instrument may recover on the note accompanying the mortgage. *D*-bank's recovery on the note would not be affected by the claim of failure of consideration, which *D* could have asserted against the seller. The court also indicated that the statement contained in the purchasing agreement constituted a valid waiver estopping *D* from asserting the defense of failure of consideration against *D*-bank. *Cotton States Mut. Ins. Co. v. Bibbee*, 131 S.E.2d 745 (W. Va. 1963).

Though prior West Virginia decisions had established the right of the holder to recover on the negotiable instrument regardless of defenses against the original payee, the instant case represents the court's first venture into the problem of waivers given in connection with the chattel mortgage or other security instrument which was a part of the transaction. This holding can have significant repercussions in instances where, for example, the debt evidenced by the note is discharged in a bankruptcy proceeding.

It is generally recognized that parties may agree to waive their contract, statutory, or other rights, so long as the waiver is not contrary to public policy. 12 AM. JUR. CONTRACTS § 181 (1938). The court in the principal case cited *Smith v. Bell*, 129 W. Va. 749, 41 S.E.2d 695 (1947), as authority for the proposition that a waiver such as the one under consideration is not contrary to public policy and is valid. The *Smith* case involved an express waiver of notice required by statute to be given a grantor when his property is sold under a deed of trust. *D* argued that the waiver was invalid for reasons of public policy, because of the inequality in the bargaining positions of the lender and the borrower. The court held the waiver valid, stating that to grant *D*'s contention would be to depart from the established course of commercial dealings and limit the source of financial credit. The court conceded that the financial position of the lender was stronger than that of the buyer, but pointed to this fact as being the very reason for the borrower's seeking money from the lender. The existence of this difference of position would not, of itself, render the transaction contrary to public policy.

In *Hoffman v. Wheeling Savings & Loan Ass'n*, 133 W. Va. 694, 57 S.E.2d 713 (1950), the court recognized that a waiver could be either express or inferred from the conduct of the parties. It was concluded that for a valid waiver to exist, all of the attendant facts together had to amount to an intentional relinquishment of a known right.

Conditional sales contracts and chattel mortgages frequently include a provision whereby the purchaser or obligor expressly waives the right to assert against the assignee of the instrument any defense which he might have set up against the seller or obligee. There may be instances where the waiver is clearly not in violation of public policy, and yet some question remains as to whether the waiver will serve as a basis for estoppel. If the waiver is held to be a valid estoppel, the purchaser will be precluded from asserting defenses against the assignee of the contract which he would have been entitled to assert against the original vendor. In *Lewis v. Dodson*, 151 Kan. 632, 100 P.2d 640 (1940), *D* signed a promissory note which was sued on by *P* as assignee of the note. The conditional sales contract accompanying the note contained a provision whereby *D* waived all rights of action, set-offs, and counter claims he might have against the seller. The jury found that *D* was induced to sign the sales agreement by fraudulent representations on the part of the seller. Notwithstanding this fact, the court held for *P*, stating that fraud was not a defense. This demonstrates a situation in which the court held the express waiver to constitute a valid estoppel, preventing the purchaser from asserting defenses against the assignee of the note which obviously would have been available against the payee.

The purchaser of an automobile under a conditional sales contract expressly agreed not to set up as a defense to an action on the contract by the assignee thereof any claim which the purchaser might have against the assignor. The assignee of the contract sued the purchaser for a deficiency judgment after repossession of the automobile. The court held that the provision in the contract was sufficient to constitute a waiver of the purchaser's right to plead failure of consideration. *Jones v. Universal C.I.T. Credit Corp.*, 88 Ga. App. 24, 75 S.E.2d 822 (1953).

The authorities seem to be fairly evenly split as to whether an express waiver will estop the purchaser from asserting defenses against the assignee which he could have asserted against the

payee of the note. Generally, the courts have found that whether the waiver constitutes a valid estoppel or not depends upon the circumstances of each particular case. Annot., 44 A.L.R.2d 8, 167 (1955). Where fraud was employed by the conditional seller in obtaining the execution of the contract, a court has held that the same fraud which vitiates the contract also vitiates the waiver, contra to *Lewis V. Dodson, supra. First Acceptance Corp. v. Kennedy*, 95 F. Supp. 861 (N.D. Iowa 1951). Decisions reaching a contrary result have indicated that an agreement in a conditional sales contract that the buyer would not assert any defense against the assignee on account of breach of warranty is binding on the buyer so far as the assignee who takes in good faith is concerned. *Glen's Falls Nat'l Bank & Trust Co. v. Sansivere*, 136 N.Y.S.2d 672 (1955). While, as indicated previously, there is substantial case law on both sides of the split of authority as to whether the waiver will be a valid estoppel in a chattel mortgage or conditional sales contract, no West Virginia cases in point have been discovered. Annot., 44 A.L.R.2d 196, 218 (1955).

A significant aspect of the waiver proposition is that this area is given specific treatment in the Uniform Commercial Code, effective in West Virginia July 1, 1964. Section 9-206 (1) provides:

“Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or lessee that he will not assert against an assignee any defense which he may have against the seller or lessor is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument  
 ....”

The intent of the above language appears to be to validate a waiver of defenses against the assignee of a security agreement. Only those defenses which would not be cut off by a holder in due course of a negotiable instrument will be available to the buyer or lessor.

It must be observed that, although the Uniform Commercial Code grants validity to a waiver of defenses by the buyer as to non-consumer goods, Section 9-206, comment (2) stresses the fact that, as to “consumer goods”, defined in Section 9-109 as “used or bought for use primarily for personal, family, or household pur-

poses", the Code takes no position. The effect given to such waiver is left entirely to state statute or case law. The comments are not enacted as part of the Code, but they do represent what the drafters consider to be the aim of the particular articles. It would appear, then, that Section 9-206 will not change the law in West Virginia as to express waivers where consumer goods are involved.

In the principal case, *D* also relied upon the "single contract" theory. The theory is recognized in a few jurisdictions and provides, in effect, that where the note is physically attached to the security agreement, they are to be regarded as one instrument. If there is some defect in the security agreement, e.g., failure of consideration, which would preclude the assignee of the "single contract" from satisfying his claim out of the secured chattel, that defect would also "contaminate" the attached note and prevent the assignee from recovering on the note as well. Very few jurisdictions appear to recognize the theory. It has been successfully asserted in several cases arising in New York, and has had more limited application in Minnesota, New Mexico, and California. That is, these courts have held that where one takes as assignee of a promissory note and a conditional sales contract, before the consideration has passed under the contract, the failure of consideration under the contract may prevent the assignee's recovery on the note. Annot., 44 A.L.R.2d 8, 46 (1955).

Of course, if the court had considered the single contract theory to be the law in West Virginia, the fact that the bank could not have satisfied its claim out of the chattel mortgage would likewise have frustrated recovery against *D* on the note. However, the court pointed out unequivocally that the theory was not the law in West Virginia nor in the majority of jurisdictions.

In jurisdictions where the single contract theory is recognized, it may operate in several ways. For example, in *First & Lumbermen's Bank of Chippewa Falls v. Buchholz*, 220 Minn. 97, 18 N.W.2d 771 (1945), the court held that where a note and a conditional sales contract were assigned simultaneously, the fact that there was some defect in the consideration would prevent the assignee from occupying the status of a holder in due course. The court pointed out that the instruments had to be construed together and that the payment of the note was conditional upon the fulfillment of the contract. In effect, the court allowed the maker of the note

to assert the same defenses against the assignee of the note as he could have asserted against the conditional seller.

*Heiman v. Murphy*, 143 Misc. 81, 256 N.Y.S. 20 (1932), illustrates another manner in which the theory may be applied. It was held that the note and conditional sales contract, which were physically attached, were to be considered and construed as a single instrument. Because the contract was non-negotiable, so also was the note.

In *Federal Credit Bureau, Inc. v. Zelkor Dining Car Corp.*, 238 App. Div. 379, 264 N.Y.S. 723 (1923), the court held that, even though the assignee's action was brought to recover on the note alone, his claim was subject to the defenses of the purchaser under the conditional sales contract. It was again declared that the attachment of the note to the contract required that the two be read together.

There is a line of West Virginia cases clearly indicating the position the State takes with regard to what effect frailties in the security agreement have on the negotiability of the note (once it is established that the note is negotiable), and on the rights of the holder in due course to recover on the note. In *Mason v. Shaffer*, 82 W. Va. 632, 96 S.E. 1023 (1918), in a suit on a promissory note by the holder in due course, *D* maker asserted as a defense failure of consideration. The court stated that the failure of consideration between the original parties to a negotiable instrument did not provide the maker of the note with a defense against the holder in due course.

A situation similar to that of the principal case was considered in *Commercial Credit Co. v. Barnett*, 116 W. Va. 132, 178 S.E. 816 (1935). This case advocates the proposition that, in the absence of a showing of bad faith on the part of the assignee, he, as a holder in due course, may recover on the note, despite the fact that the consideration failed as between the payee and the maker of the note.

In *Shanabarger v. Phares*, 86 W. Va. 64, 103 S. E. 349 (1920), the consideration failed as between the original parties to the note, which had been assigned to *P*. The court, in holding for *P*, indicated that although the note should be read together, with the instrument securing it, the latter should not be construed as a limitation

or qualification on the absolute promise to pay. This case shows an early disposition of the court to reject the results which would obtain under the single contract theory.

The question may arise as to how a situation similar to the one involved in the principal case would be treated under the Uniform Commercial Code. A recent Pennsylvania case is of particular interest in this respect because it was decided after the effective date of the Code in that state. According to *First Nat'l Bank of Philadelphia v. Anderson*, 5 Bucks 287, 7 D.&C.2d 661 (Pa. 1956), a similar result would be reached. There, the maker of a promisory note alleged that the payee under the note had failed to complete the work called for in the related contract and had supplied defective material. He further asserted that *P*, the assignee of the note, had failed to ascertain whether the contract supporting the note had been satisfactorily completed by the payee, and died therefore not occupy the status of a holder in due course. The court held that one taking a negotiable note was not obliged to inquire into the performance of the underlying contract in order to qualify as a holder in due course.

Thus, it would appear that West Virginia is in line with the strong majority view as to the defenses of which the assignee takes free as a holder in due course. Further, with regard to the problems raised in this comment, the Uniform Commercial Code will not effect a change in the law of this jurisdiction.

*John Ralph Lukens*

---

#### **Procedure—Effect of Dismissal of Venue-Giving Defendant**

Administrator of an estate brought a wrongful death action against three *Ds* in *X* county and only one of the *Ds* was a resident of *X* county. Accident occurred in *Y* county. During the trial, *P* dismissed the action as to the *D* who was the resident of *X* county and through whom the *P* obtained venue as to the nonresident *Ds*. The case was then tried on the merits and a verdict was returned for *P*. After the adverse verdict, one of the nonresident *Ds* made a motion to set aside the verdict on the grounds that the court lacked venue. Motion was overruled and *D* appealed. *Held*, affirmed. When *D* proceeded with the trial of the case without raising the question of venue in any manner, he subjected himself to a trial of the case