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Accommodation Paper Transferred After Maturity--The Defense of Lack of Consideration

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ACCOMMODATION PAPER TRANSFERRED AFTER MATURITY—THE DEFENSE OF LACK OF CONSIDERATION

The question as to the general liability of an accommodation party to a negotiable instrument which was not transferred for value until after maturity has frequently arisen. If the accommodation party has expressly restricted the accommodated party's use of the instrument, either as to the time during which the accommodation party is to be bound[1] or as to the use of the proceeds therefrom,[2] he is ordinarily permitted to use a violation of either restriction as a defense. This is done on the theory that his restriction constitutes an equity which can only be severed by the superior rights of a holder in due course, which rights one taking after maturity cannot claim.

The narrower problem to be dealt with in this note is that involving a situation in which no value is paid until after the maturity of the instrument, and under such circumstances as to make this the only defense. In other words, the accommodation party has placed no express limitations upon the accommodated party's use of the instrument and his only defense when sued by the holder who takes the instrument for value after maturity is that he is an accommodation party.

Before the adoption of the Negotiable Instruments Law, and until the decision of *Bower v. Hastings*,[3] in 1860, the American courts, as well as the English courts, had held the accommodation party liable on an instrument first transferred for value after maturity.[4] In that case D was the maker of an accommodation ninety-day note for M, in 1852, which M held until 1856, and transferred under questionable circumstances to P. The judgment of the trial court was reversed because of the refusal to admit evidence of the note's accommodation character. The trial court was directed to follow the law as stated in *Tinson v. Francis*,[5] which was cited as

[1] Wilhoit v. Seavall, 121 Kan. 239, 246 Pac. 1013 (1926); Parr v. Jewell, 16 C. B. 684, 81 E. C. L. 684, 139 Eng. R. 928 (1855); Sturtevant v. Ford, 4 M. & G. 101, 134 Eng. R. 42 (1842); Stein v. Yglesias, 3 Dowl. P. C. 252, 149 Eng. R. 1205 (1834); Charles v. Marsden, 1 Taunt. 224, 127 Eng. R. 818 (1808).

[2] Mersick v. Alderman, 77 Conn. 634, 60 Atl. 109 (1905); Tharp v. Kitchell, 151 Fla. 226, 9 S. 2d 457 (1942); Bacon v. Harris, 15 R. I. 599, 10 Atl. 647 (1887).

[3] 36 Pa. 285 (1860).

[4] Renwick v. Williams, 2 Md. 356 (1852); Grant v. Ellicott, 7 Wend. 227 (N. Y. 1831); Brown v. Mott, 7 John. 361 (N. Y. 1811); Jewell v. Parr, 13 C. B. 909, 138 Eng. R. 1460 (1853); Sturtevant v. Ford, 4 M. & G. 101, 134 Eng. R. 42 (1842); Stein v. Yglesias, 3 Dowl. P. C. 252, 149 Eng. R. 1205 (1834); Charles v. Marsden, 1 Taunt. 224, 127 Eng. R. 818 (1808).

[5] 1 Camp. 19, 170 Eng. R. 861 (1807). The facts of this case show that the matured note had been placed in the hands of an agent of the accommodated party to be returned to the accommodation

holding: "After a bill or note is due, it comes disgraced to the endorsee, and it is his duty to make inquiries concerning it. If he takes it, though he gives a full consideration for it, he takes it on the credit of the endorser and subject to all the equities with which it may be encumbered." Although the decision of this case marked the beginning of an apparent diversity of opinion in this country, a close examination of the cases arising before the passage of the Negotiable Instruments Law reveals that the majority of the courts which refused to hold the accommodation party liable did not necessarily decide the point being dealt with in this paper. Their decisions show that in practically every instance there had been a violation of an agreement or restriction,[6] or that the accommodation party had some other valid defense.[7] On the other hand, a number of courts held the accommodation party liable when his defense was that he was an accommodation party.[8]

The conclusion should be then that at the time of the adoption of the Negotiable Instruments Law the majority of American courts still followed the English rule and refused to permit the accommodation party to use the defense of lack of consideration unless that defense arose out of a violation of an agreement or restriction made by the accommodation party, or unless it was coupled with some other valid defense.

This apparent conflict of authority was not expressly dealt with by the committee which drafted the Negotiable Instruments Law. Section 29 of this law provides:

> "Liability of Accommodation Party.—An accommodation party is one who has signed the instrument as maker, drawer, acceptor, or indorser, without receiving value therefor, and for the purpose of lending his name to some other person. Such a person is liable on the instrument to a *holder for value*, notwithstanding such holder at the time of taking the instrument knew him to be only an accommodation party."

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maker and that it was the agent who transferred it for value. This would make the law as stated by Lord Ellenborough mere dictum insofar as the defense here dealt with is concerned.

[6] Kellog v. Barton, 12 Allen 527 (Mass. 1866); Mackay v. Holland, 4 Met. 69 (Mass. 1842); Wheeler v. Barrett, 20 Mo. 573 (1855); Osborn v. McClelland, 43 Ohio 284, 1 N. E. 644 (1885); Britton v. Bishop, 11 Vt. 70 (1839).

[7] Glasscock v. Smith, 25 Ala. 474 (1854); Coghlin v. May, 17 Cal. 515 (1861); Strauss v. Friend, 73 Ga. 782 (1884); Turcas v. Rogers, 3 Mart. N. S. 699 (La. 1825); Livermore v. Blood, 40 Mo. 48 (1867); Riverside Bank v. Jones, 75 App. Div. 531, 78 N. Y. Supp. 325 (1902); Hoffman v. Foster, 43 Pa. 137 (1862); Bacon v. Harris, 15 R. I. 599, 10 Atl. 647 (1887); Cottrell v. Watkins, 89 Va. 801, 17 S. E. 328 (1893).

[8] Connerly & Co. v. Planters' and Merchants' Ins. Co., 66 Ala. 432 (1880); Naef v. Potter, 226 Ill. 628, 80 N. E. 1084 (1907); Miller v. Larned, 103 Ill. 562 (1882); Warder v. Gibbs, 92 Mich. 29, 52 N. W. 73 (1892); *semble*, Dunn v. Weston, 71 Me. 270 (1880); Seyfort v. Edison, 45 N. J. Law 393 (1883).

This section is taken virtually word for word from the English Bills of Exchange Act,[9] which was used as a model by the drafters of our uniform act. This would seem necessarily to lead to the assumption that it was the intent of the committee to adopt the English rule holding the accommodation party liable, and particularly so since a majority of the American courts at that time also followed that rule.

Upon the strength of this reasoning the accommodation party should be held liable in jurisdictions where, before the passage of the uniform act, this problem had not arisen, as well as in those which had followed the English rule. In jurisdictions such as New York, however, where, before passage of the uniform act, the accommodation party to a negotiable instrument not transferred for value until after maturity had been permitted to defend simply on the ground that he was an accommodation party,[10] it may be argued that a different result might be reached. The courts of that state may contend that section 29 was not adopted subject to the construction placed upon it by the drafters of the act; but, that such a jurisdiction is free to construe that section in accordance with its previous decisions and permit no recovery. But even in these jurisdictions the English rule should be followed for the reason that it was the intent of their legislatures to enact a uniform law, and since no change was made in section 29, they must have intended to adopt it, in the spirit of uniformity, with the construction placed upon it by the drafters of the act and the English courts.

The courts which refuse to hold the accommodation party liable, however, ignore the origin of the uniform act.[11] They proceed on the assumption that lack of consideration becomes a defense after maturity and that it is only by means of the term "holder for value" in section 29, that its use as such can be avoided. They then reason that to construe the term according to its defined meaning would lead to the absurd result of refusing to accommodation parties the use of such defenses as fraud and duress, in addition to that of lack of consideration. These courts argue that the Negotiable Instruments Law, although made up of a number of provisions, is in fact only one law, and that all of its provisions must be construed together in order to determine the meaning of any one section. It is said that before the term "holder for value" can be construed as prohibiting the use of the defense that one is an accommodation party, sections 28 and 58 must be considered. Section 28 of the uniform act reads:

"Effect of Want of Consideration.—Absence or failure

[9] *Bills of Exchange Act*, 1882, Chap. 61, sec. 28 (2) 45 & 46 Vict.

[10] Chester v. Dorr, 41 N. Y. 279 (1869).

[11] Pacific-Southwest Trust & Savings Bank v. Valley Finance Corp., 99 Cal. 728, 280 Pac. 134 (1929); Hederman v. Cox, 188 Miss. 21, 193 So. 19 (1940); Rylee v. Wilkerson, 134 Miss. 663, 99 So. 901 (1924); Bartels v. Suter, 130 Okla. 7, 266 Pac. 753 (1928).

> of consideration is matter of defense as against any person not a holder in due course; and partial failure of consideration is a defense pro tanto, whether the failure is an ascertained and liquidated amount or otherwise."

Section 58 provides:

> "When Subject to Original Defenses.—In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. But a holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect of all parties prior to the latter."

These courts, which refuse to hold the accommodation party liable, then contend that since section 28 makes lack of consideration a defense against everyone except a holder in due course, and section 58 makes an instrument taken after maturity subject to the same defense as though it were non-negotiable, it is impossible to interpret the term "holder for value" as used in section 29 in any other way than as a holder for value before maturity.[12]

The very fact that section 28, which states the general rule as to the defense of lack of consideration, is immediately followed by section 29, indicates an intention to make it clear that accommodation paper constitutes an exception to that general rule—that the accommodation party is not to be permitted to use as a defense the mere fact that he received no material benefit under his contract. Furthermore, the term "holder for value" as used in this section seems to pertain alone to the defense that the defendant is "only an accommodation party." It is, therefore, unnecessary and illogical to contend that this term applies to other defenses.

Also, section 58 does not apply until such a lack of consideration as constitutes a defense is shown to be present. Since it is admitted that the accommodation party receives consideration when credit is extended in reliance upon his signature, the only basis for contending that he has not received consideration in this case is by implying that he has not requested the extension of credit after the instrument is mature. The decision of *Chester v. Dorr*,[13] is the one first applying such a fiction. In that case the court said, "It is not according to the intent or meaning of an indorsement for another's accommodation, to say that the indorser intends to give the use of his credit for any other period than that limited in the note. Or that such an indorsement imports authority to use it, when that period has elapsed."[14] And yet, at the time that decision was

[12] The same view is also expressed by Professor Brannan, *Some Necessary Amendments of the Negotiable Instruments Law* (1913) 26 HARV. L. REV. 493.

[13] 41 N. Y. 279 (1869).

[14] *Id.* at 286.

written the decisions in England and a majority of those in the United States were contra. At a time when both the courts of the United States and England were holding the accommodation party liable when his instrument had not been transferred for value until after maturity, it could not logically have been presumed that the parties to such an instrument intended that the accommodation party's liability should not extend beyond the maturity date of the instrument.

In conclusion, it is the writer's opinion that section 29 of the Negotiable Instruments Law should be construed as prohibiting the accommodation party from relying on the defense of lack of consideration except in a suit between himself and the accommodated party, unless that lack of consideration is based on some fact other than that the defendant is a mere accommodation party. If the accommodation party wishes to limit his liability to transferees taking before maturity of the instrument he should make that stipulation on its face, in which case he will be amply protected by section 58 of the uniform act.

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