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Law Determining the Status of a Possessor of Negotiable Paper

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ways present when dogmatic principles are blindly adhered to will be avoided.

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LAW DETERMINING THE STATUS OF A POSSESSOR OF NEGOTIABLE PAPER

This paper will deal with the choice of law problems relative to the status of one who is in possession of negotiable paper and who asserts claims against either the primary obligor (maker of a promissory note or acceptor of a bill of exchange) or secondary obligors (drawer of a bill of exchange and endorsers). Problems of the law applicable to the question of negotiability and the nature of the defenses raised will be treated incidentally.

Every transfer of a negotiable instrument has two aspects: First, the endorser transfers title to the instrument and the claims embodied therein; and, second, he guarantees payment by the primary obligor.

The making of the instrument and each transfer constitute separate transactions, each of which may be subject to the laws of different jurisdictions. The applicable law ordinarily is that of the place of payment. For makers and acceptors, the place of payment is that made apparent in the instrument.[1] Drawers[2] and endorsers[3] are usually deemed to have agreed to pay at their respective places of business.

Though each obligor's liability is determined by the law of his contract, it does not necessarily follow that the same law

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1. Mussou v. Lake, 45 U.S. 262, 11 L.Ed. 967 (1846); Phipps v. Harding, 70 Fed. 468, 30 L.R.A. 513 (C.C.A. 7th, 1895); Rose v. Park Bank, 20 Ind. 94, 83 Am. Dec. 306 (1863); Hunt v. Standart, 15 Ind. 33, 77 Am. Dec. 79 (1860); Smith v. Blatchford, 2 Ind. 184, 52 Am. Dec. 504 (1850); Walling v. Cushman, 238 Mass. 62, 130 N.E. 175 (1921); Hinkly v. Frienk, 86 N.J.L. 281, 90 Atl. 1108 (1914); Brownell v. Freese, 35 N.J.L. 285, 10 Am. Rep. 239 (1871); Security Trust and Sav. Bank v. Gleichmann, 50 Okla. 441; 150 Pac. 908 (1915); Nichols v. Porter, 2 W. Va. 13, 94 Am. Dec. 501 (1867).

2. Mussou v. Lake, 45 U.S. 262, 11 L.Ed. 967 (1846); Crawford v. Branch Bank, 6 Ala. 12, 41 Am. Dec. 33 (1844); Briggs v. Latham, 36 Kan. 255, 13 Pac. 393, 59 Am. Rep. 546 (1887); Hunt v. Standart, 15 Ind. 33, 77 Am. Dec. 79 (1860); Kuenzi v. Elvers, 14 La. Ann. 391, 74 Am. Dec. 434 (1859); Brownell v. Freese, 35 N.J.L. 285, 10 Am. Rep. 239 (1871); Amsinck v. Rogers, 189 N.Y. 252, 82 N.E. 134 (1907).

3. Brabston v. Gibson, 50 U.S. 263, 13 L.Ed. 131 (1850); Nathan v. Louisiana, 49 U.S. 73, 12 L.Ed. 992 (1850); Mussou v. Lake, 45 U.S. 262, 11 L.Ed. 967 (1846); Huse v. Hamblin, 29 Iowa 501, 4 Am. Rep. 244 (1870); Mackintosh v. Gibbs, 81 N.J.L. 577, 80 Atl. 554 (1911); Aymor v. Sheldon, 12 Wend. (N.Y.) 439, 27 Am. Dec. 137 (1834); Nichols v. Porter, 2 W.Va. 13, 94 Am. Dec. 501 (1867).

applies in determining whether a possessor claiming against the obligor is a holder in due course for value. It may be that, although the law of the obligor's contract will determine the extent of his liability to a certain type of possessor, the law applicable to the negotiation[4] or transfer by which the possessor acquired will determine whether he is a holder in due course.

Probably a majority of the American jurisdictions have applied the law of the obligor's contract to determine the status of the possessor; but the cases are not clear, and in some instances there is not a definite choice of law problem involved. A review of these authorities follows.

Bonds payable in Wisconsin were negotiated in New Mexico.[5] The endorsee sued the maker who set up a defense between him and the payee and contended that this defense was also available against the plaintiff who was said not to be a holder in due course for value because he had not given what is regarded as value by Wisconsin law. The court of Wisconsin excluded evidence of the law of New Mexico and applied the Wisconsin rule as to what constitutes value, holding that the law of that state became part of the maker's contract and determined the question. The case is clearly authority for the application of the law of the obligor's contract to a problem of the status of the possessor.

In *Woodruff v. Hill*,[6] a note payable in Massachusetts was negotiated in New York. The endorsee sued the maker, who claimed that failure of consideration on the part of the payee was assertable against the endorsee because he had not given value as defined by New York law. The Massachusetts court applied its own law to hold that the endorsee was a holder for value and stated that the contract of the maker with the payee and any endorsee was to be performed in Massachusetts and controlled by its law.[7]

4. The contract of endorsement is subject to the law of the place where it is made. United States v. Guaranty Trust Co., 293 U.S. 340, 55 S.Ct. 221, 79 L.Ed. 415 (1934); Brabston v. Gibson, 50 U.S. 263, 13 L.Ed. 131 (1850); Brown Valley State Bank v. Porter, 232 Fed. 434 (C.C.A. 8th, 1916); Guernsey v. Imperial Bank of Canada, 188 Fed. 300, 40 L.R.A. (N.S.) 377 (C.C.A. 8th, 1911); Phipps v. Harding, 70 Fed. 468, 30 L.R.A. 513 (C.C.A. 7th, 1895); Downer v. Chesebrough, 36 Conn. 39, 4 Am. Rep. 29 (1869); Dunnigan v. Stevens, 122 Ill. 396, 13 N.E. 651 (1887); Burr v. Beckler, 264 Ill. 230, 106 N.E. 206 (1914); Rose v. Park Bank, 20 Ind. 94, 83 Am. Dec. 306 (1863); Hunt v. Standart, 15 Ind. 33, 77 Am. Dec. 79 (1860).

5. Badger Machinery Co. v. United States Bank and Trust Co., 166 Wis. 18, 163 N.W. 188 (1917).

6. 116 Mass. 310 (1874).

7. Although the case is clear authority for applying the law of the obligor's contract, two earlier, unmentioned cases may make doubtful the

In a New York case,[8] a bill drawn in New Granada, West Indies, against drawees in New York was endorsed by the payee in New Granada. The endorsement, because lacking a date, statement of the nature of the consideration and the names of the endorser and endorsee, was invalid by New Granada law; but it was effective under the law of New York. The endorsee sued the drawer, and the New York rule was applied to hold the endorsement effective. The court reasoned that the drawer contemplated a negotiation by New York law because the endorsee's status was to be determined (upon presentment for acceptance and payment) by the drawees, who were familiar with New York law.[9]

A bill payable in New York and delivered to the payee in London was accepted in New York.[10] The payee sued the acceptor, who set up a personal defense and claimed that the payee had not taken for value. The Connecticut court held that, as the contract of acceptance was made and was to be performed in New York, its law determined whether or not the plaintiff was a holder for value.

The opinion in *Green v. Kennedy* is unreported. An appendix note[11] states the holding of the court to be that, in a suit by

state of the Massachusetts jurisprudence. In Culver v. Benedict, 13 Gray (Mass.) 7 (1859), bearer bonds issued in Indiana were delivered to the defendants in Massachusetts. The delivery was by an agent of the owner and without authority. The owner sued to recover the bonds, and to the question of whether the defendants had given value, the court applied Massachusetts law. The case is distinguishable from the principal case in that the dispute was as to title to the instrument and was not concerned with the liability of an obligor. In Ives v. Farmers' Bank, 2 Allen (Mass.) 236 (1861), a note payable in New York was endorsed in Connecticut. The endorsee sued the maker, who attempted to show that the endorsement was ineffective by the New York usury law, but the court held that law inapplicable to a negotiation in Connecticut. The court applied New York law to the question of whether the endorsee had taken for value but did state that the same rule prevailed in Connecticut.

8. Everett v. Vendryes, 19 N.Y. 436 (1859).

9. Accord: First National Bank v. Dean, 28 Jones and S. 299, 16 N.Y. Supp. 107 (1891) (status of transferee of warehouse receipt issued in New York for goods stored there and transferred in Illinois. Held, New York law as law of original contract was applicable to question of whether transferee gave value); Bright v. Judson, 47 Bar. 29 (N.Y. 1866) (bill payable in New York was delivered to the payee in Indiana. Payee sued acceptor. Held, payee not holder for value by New York law.) But see the more recent case of Weissman v. Banque de Bruxelles, 254 N.Y. 488, 173 N.E. 835 (1930), where the court stated that the possessor's title to the instrument was to be determined by the law of the place of negotiation, but held that, as the possessor was an agent for collection, his right to retain the proceeds (as against a prior holder) was to be determined by the law of the place of collection. It does not appear which law was applied in determining that the possessor was only an agent for collection.

10. Webster and Co. v. Howe Machine Co., 54 Conn. 395, 8 Atl. 482 (1886).

11. 6 Mo. App. 577 (1878).

the endorsee against the maker, a note executed and negotiated in another state, but payable in Missouri, is governed by Missouri law and that the discharge of a pre-existing debt is the giving of value.

Notes issued in Vermont were held by the payee in trust for the plaintiff.[12] In New York, the payee negotiated the notes to the defendant. The negotiation was in breach of trust, but the defendants were unaware of that. In a suit for recovery of the instruments, defendants' title depended upon whether they had given value. The court apparently applied Vermont law but stated that even if the New York law applied, the defendants had also by that law given value. The case is not strong authority either way.

On the other hand, a substantial number of courts have applied the law controlling the negotiation.

In *Brook v. Van Nest*,[13] a note payable in New York was negotiated to plaintiff in New Jersey. The makers contended that plaintiff had not given value according to New York law. The court applied New Jersey law to the question and explained that a transfer of personal property which is valid by the law of the place where such transfer is made is sufficient to pass a valid title to it.

In *United States v. Guaranty Trust Company*,[14] the Veterans' Bureau drew a check on the United States treasury. The check was payable in the District of Columbia but was mailed to the payee who resided in Yugoslavia. Through a series of forged endorsements in Yugoslavia, the defendant came into possession of the instrument and collected. After learning of the forgery, the United States sued to recover the proceeds. By the law of the District of Columbia, the defendant acquired no right under the forgeries. By Yugoslavian law, however, the defendant acquired title and the right to collect and retain the proceeds. The law of Yugoslavia was applied. The United States Supreme Court likened negotiable instruments to chattels and stated that the rule that the validity of a transfer of a chattel is determined by the law of the chattel's location at the time applied to the transfer of the check. As the checks were mailed to Yugoslavia, it was intended that they be negotiated according to that law. Acquisition of the title carried with it the right to enforce payment and

12. Keyes v. Wood, Grant and Co., 21 Vt. 331 (1849).
13. 58 N.J. L. 162, 33 Atl. 382 (1895).
14. 293 U.S. 340, 55 S.Ct. 221, 79 L.Ed. 415 (1934).

retain the proceeds. The case is strong authority for application of the law of the negotiation.[15]

A note executed in Kansas and evidently payable there was transferred in Oklahoma by the payee to his wife.[16] By Oklahoma law such an interspousal transfer was invalid. After the maker paid the payee (husband), the endorsee (wife) sued the maker, who claimed that the transfer was invalid by the Oklahoma law. The court applied Oklahoma law and emphasized not only the fact that the transfer took place there but that the parties were domiciled there. Because of the peculiar question of interspousal capacity, the case is doubtful authority.

There is no well-settled rule among the American courts,[17] as is evidenced by the imprecision of the holdings, the contradictory rulings within the jurisdictions and the unsubstantial difference in the number of authorities.

The English rule is that as against all secondary obligors[18] and primary obligors on foreign bills[19] (paper made in one country and to be paid or accepted in another country) the status of the possessor is determined by the law applicable to the negotiation in question. For primary obligors[20] on inland bills (paper made and to be paid in the same country) the view is taken that

15. Two cases in lower federal courts are in accord: McClintick v. Cummins, 3 McLean 158, Fed. Cas. No. 8699 (C.C. Ind. 1843) (capacity of endorsee corporation to discount determined by law of place of negotiation and not by law of place where note was payable); Dundas v. Bowler, 3 McLean 397, Fed. Cas. No. 4141 (S.D. Ohio 1844) (note executed in Ohio, negotiated in Pennsylvania. Held, Pennsylvania law determines validity of transfer to secure certain creditors).

16. Fogarty v. Neal, 255 S.W. 1049 (C.A. Ky. 1923).

17. Other cases have been cited one way or the other but are not decisive. Limerick Nat. Bank v. Howard, 71 N.H. 13, 51 Atl. 641 (1901) (notes payable and negotiated in same place); Woodsen v. Owens, 12 So. 207 (Miss. 1892) (same); Stout v. National Bank and Trust Co., 7 So. (2d) 824 (Miss. 1942) (same); King v. Doolittle, 1 Head 77 (Tenn. 1858) (same); Spies v. National City Bank, 174 N.Y. 222, 61 L.R.A. 193 (1903) (suit between endorser and endorsee, law of place of endorsement applicable to effect of endorsee's releasing maker); Yeatman v. Cullen, 5 Blackf. 240 (Ind. 1839) (choice between law applicable to endorsement and law of the forum); Holt v. McCann, 42 S.W. 310 (Tex., 1897) (same); Emanuel v. White, 34 Miss. 56, 69 Am. Dec. 385 (1857) (choice between law of place of payment and law of forum); Palmer v. Minor, 8 Hun 342 (N.Y. 1876); (negotiability and penal statute).

18. Alcock v. Smith, 1 Ch. 238, 61 L.J. Ch.(N.S.) 161, 65 L.T.(N.S.) 335 (1892); Embiricon v. Anglo-Austrian Bank, 1 K.B. 677, 2 B.R.C. 294, 2 Ann. Cas. 73 (1905).

19. Bradlaugh v. De Rin, L.R. 3 C.P. 538, 37 L.J. C.P.(N.S.) 318, 18 L.T.(N.S.) 904 (1868); Koechlin et Cie v. Kestenbaum Bros., 1 K.B. 889 (1927).

20. Lebel v. Tucker, L.R. 3 Q.B. 77, 37 L.J. Q.B.(N.S.) 46, 17 L.T.(N.S.) 244 (1867); In re Marseilles Extension R. and Land Co., L.R. 30 Ch. Div. 598, 55 L.J. Ch.(N.S.) 116 (1885); Alcock v. Smith, 1 Ch. 238, 61 L.J. Ch.(N.S.) 161, 65 L.T.(N.S.) 335 (1892).

the obligor contemplates paying only to one having the requisite status according to the law where the paper will circulate, and therefore the law of the obligor's contract is applicable. Thus the applicable law depends upon whether the one claiming against the possessor was in a position to contemplate a negotiation possibly subject to a law other than that applicable to his contract.

Those cases applying the law of the obligor's contract do so upon the theory that the obligor's promise is to pay only to one having the requisite status under the law controlling his contract. In other words, this is not, strictly speaking, a problem of choice of law but simply of interpreting a promise. This theory seems rather doubtful in all but a negligible number of instances. The particular type of holder to which the obligor intends to be bound is usually not considered by him, and there is ordinarily little factual basis for arriving at any particular "intent" in this regard.

Those cases applying the law of the negotiation are explained by the reasoning that a negotiable instrument, besides being evidence of a claim, is a species of property and that its transfer and the effects thereof are to be regulated as are those of a chattel. This choice of law rule based on the chattel theory is convenient, simple of application and should apply to those problems dealing solely with the ownership of the instrument. But in deciding if the property in the instrument changes hands as determined by the law of its situs at the time of the transfer in question, we do not necessarily have a choice of law rule relative to the extent to which the claim can be enforced against the obligor. It is at this point that we see that whether the owner holds in due course as against the obligor is as much a problem of the extent of the obligor's liability as it is one within the orbit of the transfer's effects.

It is suggested that the following solutions will provide a not too involved rule, protect as far as possible the expectations of the various parties, and promote economic values.

When a possessor and a prior holder are contesting the ownership of the instrument, there is no question as to the extent of liability, and the chattel rule should apply to the negotiation in dispute. Thus, if a payee seeks to recover the instrument from a remote endorsee and asserts a claim superior to the endorsee's, unless the endorsee took the instrument in good faith, the question of good faith is part of the question of transfer of title, and the law applicable to the transfer of title ought to control.[21]

21. The validity and effect of a transfer of a chattel is determined by

Similarly, if a possessor sues an obligor who, having no defense of his own, asserts an outstanding title in a prior holder (as in the first situation above) there is again no question of the extent of liability. The obligor is admitting his indebtedness but claims that another is entitled to the proceeds. Since this is purely a title question, the chattel rule[22] should apply to the negotiation in dispute and resolve whatever issue the title turns upon. This will protect the obligor from the possibility of double liability and will also guard against depriving the prior holder of the proceeds.

In the situation in which a possessor sues an obligor who does not set up a superior title in a prior holder, but contests the possessor's status in order to raise a personal defense of his own, a dilemma is presented. Are questions such as the possessor's purchase in good faith, for value and before maturity, included under the transfer of the instrument? Or are they concerned with the extent of the obligor's commitment? One choice is as sensible as the other, and it may be that one certain rule is, for convenience and simplicity, desirable. But it is in such a situation that the choice of law can promote a valuable interest, namely, marketability of commercial paper. This can be achieved by alternatively giving the possessor the benefit of that law that is more favorable to him. If by either the law applicable to the obligor's contract or that applicable to the transfer he is a holder in due course, he should be so considered.[23]

This is not unfair to the obligor. He should not be allowed to disregard the law applicable to his contract. Nor should he be permitted to deny the applicability of the law determining the transfer. It is he who has put forth the instrument which is to circulate in a territory which is a unit commercially but not legally.

Should the benefit of the alternative laws be given separately to each question involved in the problem of the due course holding? Suppose there are the questions of whether the endorsee has taken for value and in good faith. By the law of the obligor's

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the law of the chattel's situs at the time of the transfer. Banque de France v. Chase Nat. Bank, 60 F.(2d) 703 (1932); Mackey v. Pettyjohn, 6 Kan. App. 57, 49 Pac. 636 (1897); Bonchar v. Cilley, 38 Me. 553 (1854); Hallgarten v. Oldham, 135 Mass. 1, 46 Am. Rep. 433 (1883); Ames v. McCarnber, 124 Mass. 85 (1878) McKibbin v. Ellingson, 58 Minn. 205, 59 N.W. 1003 (1894); French v. Hall, 9 N.H. 137 (1838); Henry v. Philadelphia Warehouse Co., 81 Pa. 76 (1876).

22. Supra note 2.

23. See Lorenzen, The Conflict of Laws Relating to Bills and Notes (1919) 140 et seq.

contract the possessor is a holder for value but not bona fide. According to the law applicable to the negotiation by which the possessor acquired, the possessor is not a holder for value but is in good faith. Should the law of the obligor's contract apply to determine that the possessor is a holder for value and yet the law applicable to the negotiation apply to hold that he acquired in good faith? It is thought that the interests of marketability ought not to be pushed to such an extent. The possessor should be allowed the more favorable of the two laws, but that law must apply to all questions involving the due course holding.

Decisions of the few Louisiana cases follow, to show that the jurisprudence has not crystallized as to be incompatible with the proposals set forth in this paper.

In an oft-cited Louisiana case,[24] a note made in Mississippi was negotiated in Louisiana. The endorsee sued the maker, who relied upon a personal defense and a Mississippi statute whereby the maker could assert against any holder a defense available against the payee. The plaintiff contended that, as the note was endorsed in Louisiana, the law of that state applied to the question of whether the defense was assertable. The court, alluding to the rule of lex loci contractu, applied the Mississippi statute and explained,[25] "The argument [plaintiff's] takes for granted the note was negotiable, in our understanding of the term, though the very object of the statute was to take from it that character." Clearly, the problem was not one of the status of a possessor of a negotiable instrument but whether or not the instrument in question was negotiable, a question which is universally decided under the law of the primary obligation.[26]

In a court of appeal case,[27] an instrument (draft drawn by agent against principal) was executed in Honduras and payable in Louisiana. There was a negotiation to plaintiff in Honduras who then, in Louisiana, sued the principal. The defendant had a defense good against the payee and claimed that by Honduras law the endorsement constituted plaintiff only an agent for collection. The court disregarded Honduras law and determined plaintiff's

24. Ory v. Winter, 4 Mart.(N.S.) 277 (La. 1826).

25. Id. at 278.

26. The same Mississippi statute was similarly involved in Barrett v. Walker, 14 La. 303 (1840) and Murray v. Gibson, 2 La. Ann. 311 (1847). Other unauthoritative Louisiana cases are Duncan v. Sparrow, 3 Rob. 167 (La. 1842) (contract of endorsement regulated by law of place of endorsement instead of law of place where instrument is payable); Trahne and Co. v. R. H. Short and Co., 18 La. Ann. 257 (1866).

27. Andonie v. Steamship Co., 7 Orl. App. 166 (La. 1910).

status by Louisiana law. The court's view was that the maker's liability to the endorsee was to be governed by the law of the place where the obligation was to be performed. Although the court clearly applied the law of the obligor's contract, the opinion stands alone and is not from a court of last resort. The question remains an open one in Louisiana.

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CONTRIBUTORY NEGLIGENCE IN THE CONFLICT OF LAWS: SUBSTANCE OR PROCEDURE?

The rule is settled in the conflict of laws that problems of the law of torts are to be determined according to the law of the place of wrong.[1] This and other choice of law rules are designed to create substantial uniformity of result in legal controversies irrespective of where the parties may desire to litigate their grievances.[2] The Utopian goal in the conflict of laws is that every controversy, regardless of where it arises, be decided by all courts in exactly the same manner. Unfortunately, this goal could not be completely attained even if the choice of law rules were the same everywhere. The organization of courts, rules regulating process, pleading, evidence and other similar matters vary from state to state and from country to country. The necessity for effective and expeditious administration of justice makes it impossible for a court to duplicate such foreign details.[3] Thus, for their own convenience and protection, courts, as early as the Thirteenth Century, adopted the rule, which today is axiomatic, that, while problems of substantive law may be determined by foreign law, for example, in torts cases, the law of the place of wrong, procedural matters will always be determined by the forum's own rules.[4] Hence there arises the problem of demarcating problems of substantive law from problems of procedure. In this respect, it has been suggested that procedural problems "are those which concern methods of presenting to a court the operative facts upon which legal relations depend" and that problems of substantive law are "those which concern the legal effect of those facts after they have been established."[5] When one of the

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1. Restatement, Conflict of Laws (1934) §§ 378, 384.
2. Id. at introductory note to c. 12.
3. Ibid.
4. Id. at § 585.
5. Stumberg, Conflict of Laws (1937) 128.