

# Michigan Law Review

---

Volume 18 | Issue 5

---

1920

## Doctrine of Bad Faith in the Law of Negotiable Instruments

George W. Rightmire  
*College of Law, Ohio State University*

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Commercial Law Commons](#), [Common Law Commons](#), and the [Legal History Commons](#)

---

### Recommended Citation

George W. Rightmire, *Doctrine of Bad Faith in the Law of Negotiable Instruments*, 18 MICH. L. REV. 355 (1920).

Available at: <https://repository.law.umich.edu/mlr/vol18/iss5/2>

This Article is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact [mlaw.repository@umich.edu](mailto:mlaw.repository@umich.edu).

# MICHIGAN LAW REVIEW

---

VOL. XVIII.

MARCH, 1920

No. 5

---

## THE DOCTRINE OF BAD FAITH IN THE LAW OF NEGOTIABLE INSTRUMENTS

*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. Sec. 56, N. I. L.*

THIS rule is now enacted in all but two of the states of the United States; the history of its development and of its application since it became undisputed is well illustrative of the process of the common law system, and this discussion is undertaken for the purpose of discovering the general principles which a trial court should have in mind when charging a jury in a case involving the application of this doctrine.

The right of the bearer or indorsee of a commercial instrument to sue in his own name was long in developing on the continent of Europe<sup>1</sup> and its slow progress may be seen in England in the seventeenth century in the writings of Malynes<sup>2</sup> and Marius.<sup>3</sup> Cases become numerous in the reports in the last two decades of that century in which rights of various parties to a negotiable instrument are defined.<sup>4</sup> The historical controversy over promissory notes in which C. J. Holt became so demonstrative was determined by the statute of Anne,<sup>5</sup> and yet his influence in the healthy development

---

<sup>1</sup> HOLDSWORTH, ORIGINS AND EARLY HISTORY OF NEG. INSTRS., 31 L. Q. R., 18 and elsewhere, and 32 L. Q. R., 20; JENKS, EARLY HISTORY OF NEG. INSTRS., 9 L. Q. R., 70, 3 AM. L. H., 50.

<sup>2</sup> LEX MERCATORIA (1622).

<sup>3</sup> ADVICE CONCERNING BILLS OF EXCHANGE, (1651 and 1654).

<sup>4</sup> E. g., *Sheldon v. Hentley*, 2 Show., 161; *Carter v. Downish*, 1 Salk., 130; *Hodges v. Steward*, 1 Salk., 125; *Williams v. Field*, 3 Salk., 68; *Hussey v. Jacob*, 1 Comyns, 4; *Hinton's Case*, 2 Show., 236; *Anonymous*, 1 Salk., 126.

<sup>5</sup> 3 AND 4 ANNE, CHAP. 9, SEC. 4. (1704).

of negotiable instruments is noteworthy during more than two decades.\*

The development during this period was in the direction of establishing the liability of the maker or acceptor to a remote party and slight mention is found of the bona fides of the holder; in *Hinton's Case*<sup>7</sup> the court held that the plaintiff must prove that he gave a valuable consideration, for "if he came to be bearer by casualty or knavery he shall not have the benefit of it." And in the *Anonymous case* in 1 Salkeld<sup>8</sup> the transferee of a lost bill having taken a new one in his own name, the court held that trover for the bill would not lie against him because he had the bill in "the course of trade." Holdsworth says<sup>9</sup> that the negotiability doctrine emerges in a number of cases<sup>10</sup> in the last few years of the seventeenth century, "These cases go the length of holding that the holder of a bill is not liable to be met by the defenses which would be valid against his transferrer." By 1721 the principle had been recognized<sup>11</sup> that the burden was on the defendant to show that there was no consideration.

Soon after Mansfield came to the bench it was held<sup>12</sup> that one who came into possession of a stolen bill for a "full and valuable consideration in the usual courses and way of his business and without any notice or knowledge of its being taken from the mail" was entitled to payment; but payment was permitted to be withheld "until inquiry can be made whether the bearer of the note came fairly by it or no." Six years later<sup>13</sup> the question was submitted to the jury "whether the holder came into possession fairly and bona fide." J. Wilmot in that case speaks of the "greatest caution" of the holder, not the least "imputation or pretence of suspicion" that he had notice of the loss, and the holder should be held "strictly to prove his coming by it bona fide." J. Yates also mentions those matters as being important in the case.

Another case came before Mansfield in 1781<sup>14</sup> of a stolen bill indorsed several times in blank, the holder declaring under the endorsement of the payee. The defendant contended that a transferee should insist upon knowing all the circumstances and the manner

\* HOLT'S REPORTS, 1688 to 1710, MODERN REPORTS and SALKELD.

<sup>7</sup> 2 Show., 236 (1682).

<sup>8</sup> 1 Salk., 126 (1698).

<sup>9</sup> 32 L. Q. R. 20, et seq.

<sup>10</sup> Citing *Hodges v. Steward*, 1 Salk., 125 (1692); *Hussey v. Jacob*, 1 Comyns, 4 (1697); *Lambert v. Pack*, 1 Salk., 127 (1700); *Hill v. Lewis*, 1 Salk., 132 (1709).

<sup>11</sup> *Brown v. Marsh*, Gilb. Eq. Cas.

<sup>12</sup> C. J. MANSFIELD, 1756 to 1788: *Miller v. Race*, 1 Burrow, 452.

<sup>13</sup> *Grant v. Vaughan*, 3 Burrow, 1516 (1764).

<sup>14</sup> *Peacock v. Rhodes*, 2 Dougl., 633.

in which the bill had come to the indorser, but Mansfield said—"The question of *mala fides* was for the consideration of the jury. The circumstances that the buyer (of the goods) and also the drawers were strangers to the plaintiff and that he took the bill for goods on which he had a profit, were ground of suspicion very fit for their consideration. But they have considered them and have found that it was received in the course of trade, and therefore the case is clear and within the principle of all those cited from that of *Miller v. Race* downwards." The charge given to the jury is not stated and apparently has never been available.

In 1801<sup>15</sup> in a suit on a lost bill the defendant contended that "a banker or any other should not discount a bill for a person without using diligence to inquire into the circumstances as well respecting the bill as of the person who offered to discount it," admitting that "if there was any fraud in the transaction or if a bona fide consideration had not been paid for the bill by the plaintiffs, to be sure they could not recover"; but C. J. Kenyon said the rule proposed would "paralyze the circulation of paper."

So stood the law when *Gill v. Cubitt*<sup>16</sup> came before the King's Bench in 1824, on a lost bill bought from a stranger upon inquiry only as to solvency of the acceptor. The court discredited *Lawson v. Weston* and said it was accountable for much of the robbery of mail stages during the preceding years since the thief was thereby enabled to dispose of any bills very readily. The case turned on the charge to the jury "whether he (the plaintiff) took it under circumstances which ought to have excited the suspicion of a prudent and careful man." J. Bayley sheds some gratifying light on the practice of the courts when he says that in these cases (i. e., on lost and stolen bills) *up to the present one* the question submitted to the jury was—"whether the bill was taken bona fide and whether a valuable consideration was given for it," and proceeds "I consider it was part of the bona fides whether the plaintiff had asked all those questions which, in the ordinary and proper manner in which trade is conducted, a party ought to ask." He then quotes Mansfield in the case of *Peacock v. Rhodes* and continues: (see note 14) then if in that case those were questions fit for the consideration of the jury as part and parcel of the question of bona fides, is it not also a fit and proper question for their consideration whether he has inquired with that degree of caution which, in the ordinary course of trade a prudent trader ought to use? And the charge was upheld.

Now in all these cases of lost and stolen bills the court had

<sup>15</sup> *Lawson v. Weston*, 4 Esp. 56.

<sup>16</sup> 3 B. and C., 466.

said in 1758 that the plaintiff took the bill for a full and valuable consideration and in the usual course of business; in 1764 that the plaintiff took fairly and bona fide in the course of trade and even with the greatest caution; in 1781 the court again speaks of taking in the course of trade. Apparently "the course of trade" implied some inquiry, exercise of caution, such as a prudent trader would use. And in *Gill v. Cubitt* the course of trade is referred to as determining the rights of the holder; here for the first time do we find a reported instance of the court attempting to give the jury a somewhat analytical statement of the law of *bona fides* and directing their attention to suspicious circumstances proper to be considered in determining *bona fides*. What charges were given to juries in the cases during the period 1758 to 1824, and how the question of the good or bad faith of the holder was to be determined we do not know from the reports, except from the above mentioned allusion by J. Bayley; we may, however, conclude that they did not descend into detail in defining good faith or bad faith, since no mention of such charge is made in the reports of the period or in any since or in any discussion of this question. Hence the inference seems proper that here the court was attempting such definition of the law as the facts seemed to demand, and in doing so raised a new question, in the determination of which the earlier cases are of little authority and the ultimate settlement of which would depend upon how the freest circulation of negotiable paper could be secured consistent with safety in commercial transactions.

During the next decade several cases follow this rule,<sup>21</sup> but in 1834<sup>22</sup> the jury were instructed to find for the plaintiff if they thought he had not been guilty of *gross negligence* in taking the bill under the circumstances in evidence; the requested charge which was denied in this case was: "\* \* \* whether the circumstances ought to have excited the suspicion of a prudent man," in accord with *Gill v. Cubitt*. In 1836<sup>23</sup> the court held that the case should not go to the jury on the question of *gross negligence*, since that was not a sufficient answer to an allegation of good faith and value; but the proper rule was stated to be that where the bill has passed to the plaintiff without any proof of *bad faith* in him there is no objection to his title. Three years later<sup>24</sup> it was held insufficient to charge the plaintiff with *mala fides* by averring that he was not "the bona

---

<sup>21</sup> *Down v. Halling*, 4 B. and C., 330; *Snow v. Peacock*, 2 Car. and Payne, 215; *Beckwith v. Corral*, 2 Car. and Payne, 261.

<sup>22</sup> *Crook v. Jadis*, 3 B. and Ad., 900.

<sup>23</sup> *Goodman v. Harvey*, 4 Ad. and El., 870.

<sup>24</sup> *Uther v. Rich*, 10 Ad. and El., 784.

fide holder of the bill", but the rule was announced that *mala fides* must be distinctly alleged.

A little later<sup>21</sup> in a case of fraud on the drawer the plea alleged knowledge and notice thereof in the plaintiff and the court construed this defense to mean "not merely express notice, but knowledge or the means of knowledge to which the party willfully shuts his eyes."

This summary view shows that by 1847 in England the doctrine of "bad faith" as applicable to the holder plaintiff (or defendant in some actions) had become thoroughly established, and it may be expressed as follows:—Where extraneous circumstances are relied upon to defeat the title of the holder of a bill or note the plea must specifically allege bad faith in the holder; and bad faith is proven by showing knowledge of the circumstances or means of knowledge to which the holder willfully shuts his eyes. The trial courts were busy in endeavoring to give definition to that doctrine in elaborating the instructions to the jury. The new doctrine elicited many questions the answers to which would, in accordance with the universal experience under the common law system, give direction to the movement of the doctrine among the many groups of facts to which it must be applied.

The rule thus clearly established in England has not been questioned there since; and whether it is the rule prior to 1800 reaffirmed, as most writers and courts have stated, or whether it is the result of an effort to give sharper definition to the law as a result of the widening use and importance of the negotiable instrument, as concluded herein, is probably not so material; yet as a matter of historical import the conclusion is worth uttering in order to get it "into the record."

The doctrine will now be followed in the United States.

In KENT'S COMMENTARIES, Vol. 3, at pages 81 and 82 the rule of "suspicious circumstances" is discussed, and several American cases are cited in support thereof, and particular attention is given to *Gill v. Cubitt* and its effect on the earlier decision in *Lawson v. Weston*. This work came out in 1828.

Story wrote his "PROMISSORY NOTES" in 1845, and his "BILLS" a few years earlier, summarizing much of the latter work relating to the subject of bona fide holder in the former; the status of the doctrine of bad faith at that time he thus expresses.<sup>22</sup>—"But the reasonable doctrine now established is that nothing short of fraud, not even gross negligence, if unattended with *mala fides* on the part of the

<sup>21</sup> *May v. Chapman*, 16 M. and W., 355 (1847).

<sup>22</sup> Sec. 382.

maker or other party *paying a note*, will invalidate the payment so as to take away the rights founded thereon." This is a strange statement and it is not found that any other writer or any court has attached this doctrine to the payer to disable him, and Story's meaning here is not apparent. In an earlier section<sup>23</sup> he says that the doctrine of suspicious circumstances or without due caution and inquiry was overruled by *Goodman v. Harvey*. In the same section he expresses in a summary way what he regards as the substance of the rules worked out in his "BILLS",<sup>24</sup> namely, "it will be sufficient if the circumstances are of such a strong and pointed character as necessarily to cast a shade upon the transaction, and to put the holder upon inquiry." Hence the outcome of Story's investigations is to fasten the doctrine of bad faith upon the maker or other payer of the instrument, and the doctrine of "circumstances such as to put the taker upon inquiry" upon the holder. If the latter ever was the principle in force in the United States, and there is good authority for thinking so<sup>25</sup>, it was beginning to lose ground and was discredited in 1857 by the United States Supreme Court.<sup>26</sup>

The second edition of EDWARDS ON BILLS AND NOTES appeared in 1863; and in it he lays down the doctrine of *Goodman v. Simonds*<sup>27</sup> and finds early cases to support it.<sup>28</sup>

PARSONS ON NOTES AND BILLS appeared in 1862 and in reviewing the stages of the rule in England he says that Lord Tenterden's doctrine of suspicious circumstances was widely adopted in the United States but Lord Denman's doctrine of *mala fides* was adopted as a substitute in many jurisdictions, and was affirmed by *Goodman v. Simonds*,<sup>29</sup> concluding that the *mala fides* doctrine is in general if not universal use.<sup>30</sup>

Daniel<sup>31</sup> is in general accord with Parsons as to the stages of the history of the rule and as to the weight of *Goodman v. Simonds*.

Let us now look at this case. It involved an accepted bill which was forwarded to the drawer payee to be by him used for a certain purpose; he misappropriated it for his own benefit by transferring

<sup>23</sup> Sec. 197.

<sup>24</sup> Secs. 415, 416, and 178 to 194 generally.

<sup>25</sup> KENT'S COMMENTARIES, above, and PARSON'S, below.

<sup>26</sup> *Goodman v. Simonds*, 20 How. 343.

<sup>27</sup> 20 How., 343.

<sup>28</sup> Top paging, pp. 300 and 302, and marginal paging, pp. 318 and 320, citing New York and Mass. cases.

<sup>29</sup> 20 How., 343.

<sup>30</sup> Vol. 1, pp. 258 to 260, and notes; Vol. 2, pp. 266 to 280 and notes.

<sup>31</sup> DANIEL ON NEGOTIABLE INSTRUMENTS, 16th. ed. Secs. 770 to 776a.

to Goodman and Co., one member of the firm being the plaintiff therein. The following charge was given to the jury:—<sup>23</sup>

“If the jury find from the evidence in the case that Wallace Sigerson (drawer) never had any interest in the bill sued on nor in the proceeds thereof, nor any authority to use the same for his own benefit, and did dispose of the same for his own benefit to T. S. Goodman and Company and the plaintiff (holder) was at the time one of said firm, and when the bill was so transferred to said firm such *facts and circumstances were known* to the said Goodman (plaintiff) as caused him to *suspect or that would have caused one of ordinary prudence to suspect* that said Wallace Sigerson had no interest in the bill, and no authority to use the same for his own benefit, and by ordinary diligence could have ascertained that said Wallace Sigerson had no interest in said bill, and no authority to use the same for his own benefit, they will find for the defendant.”

Justice Clifford makes the most comprehensive review and statement of the law that had appeared at that time and expresses four rules for ascertaining the status of the holder:—

A.—If the facts noticed are on the instrument the question of knowledge is one of law, i. e., depends upon the construction of the instrument.

B.—If the facts relied upon to discredit the title of the holder are outside of the instrument the question of knowledge is one of fact.

C.—If actual knowledge (of the infirmity in the instrument or defect in title) is not found from the facts in evidence the holder recovers, unless

D.—The holder took the instrument in bad faith; and willfully shutting the eyes to the means of knowledge which one knows are at hand is plenary evidence of bad faith.

On this reasoning of course the exception to the instruction was allowed.

This decision firmly fixes the rule of “bad faith” in American jurisprudence, and the reasons for approving the rule were never more cogently expressed; the reasons for rejecting the rule of suspicious circumstances have been forcefully stated elsewhere, also, both in England and America. In 3 CAMPBELL’S LIVES, 310, it is said that this doctrine was untenable and inconsistent with the theory of negotiable instruments, because no test could be laid down to determine the circumstances which ought to excite suspicion. In

<sup>23</sup> 20 How., 343, at p. 344.



*Crook v. Jadis*<sup>23</sup> the court said that "reasonable caution" in such matters was hard to define and a dangerous question to leave to a jury. A rather complete statement of the reasons for the "bad faith" rule was made by C. J. Beasley<sup>24</sup> twelve years after *Goodman v. Simonds* when, after tracing the rule historically, he says that the doctrine of suspicious circumstances could not provide a judicial standard by which such circumstances "could be measured before submitting them to a jury, and it is precisely this want which the modern rule supplies. When *mala fides* is the point of inquiry, suspicious circumstances must be of a substantial character, and if such circumstances do not appear the court can arrest the inquiry.

"Under the former practice circumstances of slight suspicion would take the case to the jury; under the present rule the circumstances must be strong so that bad faith can be reasonably inferred. Thus the subject has passed from the indefinite to the comparatively definite; from the intangible to the comparatively tangible. From a mere matter of fact the question to some extent has become a matter of law.

"I cannot doubt that, when we recollect that inquiries of this nature always attend that class of cases where judgments are sought against innocent and unfortunate parties, the change is most beneficial. All experience has shown how hard it is to prevent juries from seizing on the slightest circumstance to avoid giving a verdict against the maker of a note which has been obtained by fraud or theft.

"To preserve the negotiability of commercial paper and guard the interests of trade it is absolutely necessary that large power should be placed in the judicial hand when the question arises as to what facts are sufficient to defeat the claim of a holder of the note or bill which has been taken before maturity and for which value has been paid. It is only in this mode that the requisite stability in transactions of this kind can be maintained.

"But I do not think the difference in the two rules above discussed is so great as some persons have supposed. In my apprehension the entire variance consists in the degree of proof which the court will require in order to submit the inquiry to the jury."<sup>25</sup>

<sup>23</sup> 3 B. and Ad., 909.

<sup>24</sup> *Hamilton v. Vought*, 34 N. J. L., 187 (1870).

<sup>25</sup> It is thought that there is no general agreement with C. J. Beasley in this position among the American Courts; in New York the court has directed a verdict where there was no evidence of bad faith, even where the plaintiff's case was made from cross examination of defendant's witness, *Amer. Ex. Natl. Bank v. The N. Y. & Co.*, 148 N. Y., 698; *Hamilton Natl. Bank v. Upton*, 91 N. Y. Supp., 475. If nothing from which a reasonable inference of bad faith can be drawn the verdict should be directed, *Bank v. Stackhouse*, 91 S. C., 455. Where there is some evidence of fraud it is proper to

Mere carelessness in taking the paper will not, of itself, impair the title so acquired; but carelessness may be so gross that bad faith may be inferred from it. Nor is it necessary, in order to defeat the title of the holder, that he have actual knowledge of the facts and circumstances constituting the fraud; it is sufficient if he have knowledge that the paper is tainted with any fraud, although he may be ignorant of the nature of it."

He then quotes from *May v. Chapman*,<sup>22</sup> to the effect that knowledge and notice mean not merely express notice but knowledge or the means of knowledge to which the holder willfully shuts his eyes.<sup>23a</sup>

American courts generally<sup>23b</sup> do not follow the above rule as to submitting the case to the jury, but send it to the jury unless evidence is entirely lacking on one side, or there could be no doubt as to what the evidence establishes. The latter is a rare case indeed, since the matter of credibility is for the jury to determine as well as the effect of the remainder after the incredible has been sifted out. Although C. J. Beasley's discussion above has been the subject of much favorable comment judicially, it is not seen that it has given much aid to the judge in ruling on evidence or directing a verdict or charging a jury. Nor is it seen that there is much aid given a trial court in any of the above cases on the charge to the jury as to the scope of the term "bad faith." There must be some general

---

submit the case to the jury, *Bank v. Jordan*, 139 Ia., 499. Although plaintiff's evidence is not contradicted, all evidence should go to the jury, for the evidence of plaintiff may nevertheless be discredited, *McKnight v. Parsons*, 136 Ia., 390; *Bank v. Hoffman*, 229 Pa. St., 429; *Citz. Sav. Bank v. Houchens*, 64 Wash., 275. And the Idaho court in *First Natl. Bank v. Hall*, 31 Idaho 167, after reviewing many cases in other states and in Idaho, finds the rule to be that the question whether or not a transferee of a promissory note is a bona-fide purchaser in due course is one for the jury, save in those instances where the testimony is not only consistent with the good faith of such purchaser, but is such that no fair-minded person could draw any other inference therefrom, and then further qualifies the rule thus: "Where the good faith of a party who claims to be the holder in due course of a negotiable instrument is an issue upon which he has the burden of proof, the credibility of his testimony in support of that issue, although uncontradicted, is for the jury." (The burden falls upon the holder under the conditions prescribed in N. I. L., Sec. 59.)

A peremptory instruction is proper where there is no evidence contradicting plaintiff's evidence of good faith, *Bothwell v. Corum*, 135 Ky., 766; and where shown that a corporation note made by an officer is being used by that officer for his own purposes, *Kenyon Co. v. Bank*, 140 Ky., 133; and where a partnership indorsement appears as an accommodation presumably and there was no inquiry, *Bank v. Low*, 127 Mass., 72.

These cases are exceptional in part, and the general rule is that the whole case goes to the jury if on no other ground than that they are the judges of credibility as well as weight.

<sup>22</sup> 16 M. and W., 355.

<sup>23a</sup> This rule of course has no application where the defect or infirmity appears on the instrument, as provided in the first branch of the rule of Sec. 56.

<sup>23b</sup> See note <sup>24a</sup> above.

principles determinative of the scope and conditions of application of this term which a court may give to a jury *mutatis mutandis* with the state of the evidence, and a liberal selection of cases will now be noticed to ascertain how this doctrine is applied.

Since the able exposition of this doctrine in the United States Supreme Court in 1857 it has made great headway in the states, even before the adoption of the N. I. L., so that its application appears in the decisions both before and since that code; states in which the doctrine prevailed prior to the code would find no change in the application thereof because of the code, and other states first construing the rule as a statute would apply the usual principles of statutory construction. The chief materials to be sought in this review are the rulings on evidence and the instructions to juries, and the reasoning of the reviewing courts on the exceptions thereto.

The courts in the cases now to be noticed have recognized two situations bearing on the rights of a holder; one where some fact apparent on the instrument is relied upon—such as a firm or company signature in a certain apparent relationship to the instrument, or there is a recital, or a trust relationship is indicated; the other where facts extraneous to the instrument are relied upon—such as breach of faith, or fraudulent representations in the inception of the instrument.<sup>26</sup> In both of these situations the courts have spoken of the taker's being put upon inquiry and therefore held to know any pertinent facts which such inquiry reasonably pursued would have developed. They have also said that the person who is put upon inquiry is the reasonably prudent man, and they have repeated and varied these assertions as fundamental conceptions with striking tenacity. In both types of cases the courts have also endeavored to apply the "bad faith" doctrine.

Looking first at the case where the instrument on its face or back contains a pertinent fact, the views of the courts are shown by their own statements of the gist of the matter:—

Such fact puts the taker on inquiry, i. e., charges him with notice of the facts such inquiry would develop;<sup>27</sup> or, charges him with knowledge of the facts;<sup>28</sup> and in a commercial sense the taker has acted in bad faith in taking the instrument;<sup>29</sup> a person taking a

<sup>26</sup> See *Goodman v. Simonds*, 20 How., 343.

<sup>27</sup> *Buckley v. Lincoln Trust Co.*, 131 N. Y. Supp., 105; *Gaston v. Campbell*, 130 S. W., 222 (Texas, 1910); *Chicago & Co. v. Brigger*, 196 Ill., 96.

<sup>28</sup> *Redfield v. Wells*, 31 Ida., 415; *Newman v. Newman*, 145 N. Y. Supp., 325; *Fensterer v. Pressure Lighting Co.*, 149 N. Y. Supp., 49; *Smith v. Weston*, 158 N. Y., 194; *Bank v. Connolly*, 88 Vt., 55.

<sup>29</sup> *Rochester & Co. v. Paviour*, 164 N. Y., 281; *Ward v. City Trust Co.*, 192 N. Y., 61.

note to the order of one as "guardian" is charged with notice of the trust and bound to exercise a high degree of caution, and should make a thorough inquiry;" and an omission to inquire exhibits heedlessness or a purpose not to scrutinize;" the transaction of purchase by the holder is prima facie bad, bad until shown to be good, and no question of good faith arises in such case;" it is also said that when the marks of infirmity on the instrument would put an ordinarily prudent person on inquiry, the indorsee takes the same subject to the infirmity;" under such conditions the question of notice is one of construction for the court;" again, such marks carry notice to a purchaser of possible want of power to make the instrument, and are sufficient to put the taker on his guard—to put a discounting bank upon inquiry and it must bear the loss.<sup>44</sup>

The rule which the courts are applying in these cases seems to be that the taker is charged with knowledge of the situation, and also that the taker is thereby put upon inquiry; apparently these two statements are equivalents when applied to such cases. It has indeed been held<sup>45</sup> that under Sec. 56 N. I. L. the indorsement by the transferor in question as "trustee" is actual knowledge to the taker of the relation which he bears to the paper. Hence there seems to be no need for the two statements above and their continued use is misleading; the question of knowledge raised is one of law to be answered by the construction placed upon the instrument by the court, and therefore as a matter of law the taker should be affected with the results of the situation whether he makes any inquiry or not. Of course the actual situation that exists will be shown by the evidence as usual. The rule governing a case where the marks of the infirmity are found upon the instrument therefore is that the taker legally knows the situation which is legally indicated thereby. This notice is the "actual knowledge" of Sec. 56, since for all purposes of determining his rights the holder's position is the same as if he actually knew the conditions which are now confronting him in evidence. As said in Massachusetts:—

"Where the corporation note or other negotiable instrument is payable to the creditor of the individual (officer executing it) the transaction which on the face of the note or other instrument is

---

<sup>44</sup> *Strong v. Strauss*, 40 Oh. St., 87; *Ford v. Brown*, 114 Tenn., 477, 479.

<sup>45</sup> *U. S. Exch. Bank v. Zimmerman*, 113 N. Y. Supp., 33.

<sup>46</sup> *Johnson Co. v. Longley Co.*, 207 Mass., 52.

<sup>47</sup> *Jenkins v. Bank*, 126 Pac., 757 (Okla., 1912).

<sup>48</sup> *Goodman v. Simonds*, 20 How., 343; *Collins v. Gilbert*, 94 U. S., 753, 758; *Re Troy and Cohoes Co.*, 136 Fed., 420.

<sup>49</sup> *West St. L. Bank v. Shawnee Co. Bank*, 95 U. S., 557.

<sup>50</sup> *Ford v. Brown*, 114 Tenn., 477.

represented to have taken place is an appropriation of the corporation's money to the payment of the individual's debt and is bad unless shown to be good. Since the transaction is bad unless shown to be good, and since the purchaser took with notice, his rights depend upon the transaction's being or not being what it purports on the face of the instrument to be, and no question of a purchase in good faith can arise." But in a case where the transaction which on the face of the instrument is represented to have taken place is a legally proper transaction, and the "corporation proves that the application of the note or other instrument was a wrongful one, the rights of the creditor depend upon his having acted in good faith."<sup>41</sup>

In the Tennessee case above cited<sup>42</sup> the court after a careful review of many authorities<sup>43</sup> holds that the indorsee has actual knowledge, and the Texas and the Federal authorities are in accord.<sup>44</sup> It is believed that the reasoning in these cases is applicable to all cases in which the instrument contains upon itself the indications of the defect or infirmity (see note 38), and many of the cases which tenaciously lay down the rule as to the necessity of inquiry also conclude that the taker is chargeable with such facts as the inquiry would disclose.<sup>45</sup> Why, then, make a requirement as to inquiry? If there was no defect or infirmity certainly an inquiry would not be needed, for there would in fact be no defense of the kind under discussion, and the only defense would be that no inquiry was made. But that is no defense for it is abundantly settled that there is no general duty to inquire.<sup>46</sup> If there was a defect or infirmity the situation is what is indicated by the instrument, and if this indication puts him on inquiry and if (per rule) he is bound by what such inquiry can develop, then clearly he is bound whether he inquires or not, the only difference being that if he had inquired he would not have taken the instrument and hence the case would never have arisen. Or if he had inquired and the situation had been misrepresented he has legally acquired "actual knowledge" upon which he may safely act.

As to the case where an inquiry would not uncover the defect or infirmity he will not in the suit be bound thereby if shown, because per assumption such defect or infirmity was not discoverable at the time of the transfer.

<sup>41</sup> *Johnson Co. v. Langley Co.*, 207 Mass., 52.

<sup>42</sup> *Ford v. Brown*, 114 Tenn., 477.

<sup>43</sup> *Ford v. Brown*, 114 Tenn., 467, at pages 475 to 481.

<sup>44</sup> *Forster v. Enid*, 176 S. W. (Tex., 1915) 788; *El Fresnel Co. v. Bank*, 182 S. W. (Tex., 1916) 701; *Swift v. Smith*, 102 U. S., 442.

<sup>45</sup> *Cohnfeld v. Tannenbaum*, 176 N. Y., 126.

<sup>46</sup> *Goodman v. Simonds*, 20 How., 343, and many others noted above. Also *Wilson v. Metr. Co.*, 120 N. Y., 145, and *Bank v. Looney*, 99 Tenn., 278.

It is appreciated that not all the cases support the above conclusions, but they are supported by ample authority, they express a simple rule readily applied and relieve the deliberations of the court of the confusing and ineffective terms "ordinarily prudent man" and "putting on inquiry." These terms have a large place in the law of ordinary contracts and form a guide in some equitable situations, but they have no proper place in the contract of negotiable instrument where the infirmity or defect appears upon the instrument itself.<sup>40</sup>

The other case which is included under the term "actual knowledge" of Sec. 56 is where the taker was given specific information about the facts which constitute the infirmity or defect, and such case obviously needs no discussion to show the disability of the taker.<sup>41</sup>

The next case to be considered is that where the infirmity in the instrument or defect in title must be shown by extraneous facts, such as fraud, undue influence, illegality or breach of faith, included under the last branch of the rule of Sec. 56. Here there has been much confusion and controversy, also. The evidence that must be considered in this connection relates to the transaction by which the instrument came to the hands of the holder, and has nothing to do with the fact which constitutes the infirmity or defect. Of course, where there is actually no infirmity or defect, the conduct of the taker and his frame of mind at the time of the transfer to him are inconsequential—in short there is no case, as set out above.

Hence, all our discussion must assume an infirmity or defect.

The Massachusetts court<sup>42</sup> sharply distinguishes this case from the one discussed above, and regards the transaction by which the holder came into possession of the instrument as good until it is shown to be bad, and the showing is dependent upon the good faith of the taker. The ultimate question in this type of cases is—When does bad faith exist? and the penultimate question of course is—What is bad faith? From a review of the cases a variety of statements of a rule may be obtained, expressed as follows:—

Bad faith is not shown by knowledge of facts or circumstances sufficient to arouse suspicion in the mind of a person of ordinary prudence who is guilty of negligence in not first following up such information;<sup>43</sup> knowledge of the infirmity is the test applied in one

<sup>40</sup> *Fidelity Co. v. Mays*, 142 Ga., 821; *Bank v. Gleichmann*, 150 Pac., 908 (Okla.); *Voris v. Birdsall*, 162 Pac., 951 (Okla., 1917).

<sup>41</sup> *Jackson v. Jones*, 94 Ark., 426.

<sup>42</sup> *Johnson Co. v. Longley Co.*, 207 Mass., 52.

<sup>43</sup> *St. Joe Co. v. Bank*, 50 Pac., 1055 (Colo.)

jurisdiction;<sup>64</sup> it is not shown by a failure to make such inquiries as a person of ordinary prudence would about his own business;<sup>65</sup> but if the taker knew such facts as excited suspicion about the paper such that he feared to make an inquiry lest it would disclose a defence and consequently he shut his eyes and bought in the dark, bad faith is shown;<sup>66</sup> willful neglect to pursue facts of which he has knowledge is sufficient;<sup>67</sup> or such gross carelessness as fairly tends to the conclusion of bad faith;<sup>68</sup> mere failure to make such inquiry as might seem prudent to the jury is not bad faith;<sup>69</sup> reasonable cause and actual knowledge are not the same nor is the latter a test of bad faith;<sup>70</sup> the test of bad faith is<sup>71</sup>—"were the circumstances under which the note was purchased such as to be prima facie inconsistent with any other view than that there was something wrong in the title to the note and therefore such as to give constructive notice of the defenses thereto. In order to charge a purchaser with notice it is not sufficient to charge him with notice or knowledge of facts which would put an ordinarily prudent person on inquiry or on his guard; he must have knowledge or notice of such facts that his failure to make inquiry amounts to bad faith," and "in order to charge an indorsee with constructive notice the facts must be such as to impute fraud or actual bad faith."<sup>72</sup>

The "suspicious circumstances" test in this connection receives complete refutation as a working hypothesis in most of the cases, but nowhere more felicitously expressed than in Missouri<sup>73</sup> and in the United States Supreme Court in an early case<sup>74</sup> and in California.<sup>75</sup>

In applying the test of bad faith some courts have felt called upon to distinguish between knowledge of facts which results on the one hand in suspicion and on the other in belief.<sup>76</sup> This is somewhat metaphysical at first impression but it is illustrative of the action of the legal mind in endeavoring to arrive at working form-

<sup>64</sup> *Standard Co. v. Windham N. Bank*, 71 Conn., 668.

<sup>65</sup> *Comstock v. Hannah*, 76 Ills., 530.

<sup>66</sup> *Iowa N. Bank v. Carter*, 144 Ia., 715; *Walters v. Rock*, 115 N. W., 513 (N. Dak.)

<sup>67</sup> *Bank v. Shaffer*, 147 N. W., 851 (Iowa).

<sup>68</sup> *Lee v. Whitney*, 149 Mass., 449.

<sup>69</sup> *Clark v. Roberts*, 206 Mass., 235.

<sup>70</sup> *Park v. Winsor*, 115 Minn., 256.

<sup>71</sup> *Bank v. Beecher*, 133 Minn., 81.

<sup>72</sup> *Hamilton v. Marks*, 63 Mo., 167, 177.

<sup>73</sup> *Murray v. Lardner*, 2 Wall., 110, 121, 122.

<sup>74</sup> *Sinkler v. Siljean*, 136 Cal., 356; *Eemes v. Crosier*, 101 Cal., 260; *Reilly v. McKinnon*, 159 Fed., 78; *Kavanagh v. Bank*, 239 Ills., 404.

<sup>75</sup> *Link v. Jackson*, 164 Mo. App., 195; *Bank v. Cape Girardeau Co.*, 155 S. W. (Mo.) 1111; *Bank v. Borchers*, 83 Neb., 530; *Doe v. N. W. Coal Co.*, 78 Fed., 62.

ulae, and it is believed to be logical and to embody the proper test. This is expressed as follows:—

“Actual knowledge does not mean such knowledge as would enable one to testify on the subject; but such knowledge as would justify the jury in finding that plaintiff purchased the note in the *belief*, not merely on *suspicion*, that the note was procured by fraud. If plaintiff had such knowledge bearing on the fraud as to cause him to believe that it was procured by fraud, then, so far as his action in purchasing is concerned, he knew that the note was procured by fraud.

“Knowledge of facts going no further than to arouse suspicion is not sufficient; but when the impression made upon the mind by such knowledge passes from suspicion to belief, it then becomes knowledge.

“Knowledge of fraud is knowledge of such facts as would cause a reasonably prudent man to believe in the existence of fraud, and if such facts were brought home to plaintiff, he would be chargeable with knowledge whether he actually believed that the note was procured by fraud or not. And if he actually believed in the existence of the fraud when purchasing the note it is immaterial how meager the facts may be which induced that belief.”

The distinction between the case where the discrediting facts appear on the instrument and where they are extraneous appears in some Oklahoma cases, and it is worth noting here as an aid to understanding the latter case. In the *Jenkins case* (see note 44) where a corporation note was being used for personal obligations by the officer who made it, the court uses the phrase long acclimated in equity proceedings about putting an ordinarily prudent man on inquiry but at the same time holds the taker affected with all the legal results of the actual situation; but in a line of cases where the question of good faith is involved and hence extraneous facts determine rights of the taker,<sup>64</sup> the court before and since the adoption in that state of the N. I. L. have followed the bad faith doctrine. Accordingly an instruction to the jury which would have passed muster in the former kind of case there was repudiated in the latter, although its applicability to equity situations and other kinds of contracts in general was recognized. This holding is particularly important because made in express view of Sec. 56.

---

<sup>64</sup> *Bank v. Pickard*, 129 Pac., 38 (Okla.); *Forbes v. Bank*, 95 Pac., 785; *Bank v. Wade*, 111 Pac., 205; *Bank v. Landis*, 132 Pac., 1101; *McFerrin v. Tittle*, 129 Pac., 721.



It has also been laid down as the test<sup>65</sup> that bad faith implies guilty knowledge or willful ignorance (of extraneous facts); and again<sup>66</sup> it is said that bad faith is something more than failure to inquire into paper because of rumors, or general reputation, as to the bad character of the maker; also that willful ignorance is as bad as guilty knowledge and both involve the result of bad faith.<sup>67</sup>

As further illustrative of the efforts of the courts to express a fundamental test a group of cases in Idaho<sup>68</sup> is rather noteworthy, because they were decided under the N. I. L. provisions, they involve the defense of fraudulent representations and are directly on the point, and they came before the Supreme Court in a short period of time, thereby giving the most impressive opportunity to work out general principles relating to bad faith that has come to any court in this country.

In the *Winter case* the court approves the language in *Gray v. Boyle*,<sup>69</sup> namely, "The holder is not bound at his peril to be on the alert for circumstances which might possibly excite the suspicion of wary vigilance. He does not owe to the party<sup>70</sup> who puts the paper afloat the duty of active inquiry in order to avert the imputation of bad faith. The rights of the holder are to be determined by the simple test of honesty and good faith, and not by a speculative issue as to his diligence or negligence. The holder's right cannot be defeated without proof of actual notice of the defect in title or bad faith on his part evidenced by circumstances. Though he may have been negligent in taking the paper and omitted precautions which a prudent man would have taken, nevertheless, unless he acted mala fide, his title, according to settled doctrines, will prevail." The Idaho court cited the provisions of the N. I. L., quoted approvingly from other cases also in other states construing such provisions, and summarizes the rule to be followed thus:—

"We think it is only actual knowledge of the defect or infirmity, or notice of such facts and circumstances as would put a man on inquiry and would charge him with bad faith or the imputation of dishonest dealing, that was intended by the statute to defeat a recovery." This test is analyzed below.

<sup>65</sup> *Hotchkiss v. N. Banks*, 21 Wall., 354; *Murray v. Lardner*, 2 Wall., 110.

<sup>66</sup> *Goetz v. Bank*, 119 U. S., 55; *Brent v. Simpson*, 238 Fed., 285.

<sup>67</sup> *Murray v. Lardner*, 2 Wall., 110.

<sup>68</sup> *Winter v. Nobs*, 19 Ida., 18; *Shellenberger v. Nourse*, 20 Ida., 323; *Park v. Johnson*, 20 Ida., 548; *Park v. Brandt*, 20 Ida., 660; *Vaughn v. Johnson*, 20 Ida., 669; *Vaughan v. Brandt*, 21 Ida., 628; *Southwest N. Bank v. Baker*, 23 Ida., 428; *Burdell v. Nereson*, 28 Ida., 129; *Southwest N. Bank v. Lindsley*, 29 Ida., 343; *First N. Bank v. Hall*, 31 Ida., 167; *Redfield v. Wells*, 31 Ida., 415.

<sup>69</sup> 55 Wash., 578.

<sup>70</sup> *Murray v. Lardner*, 2 Wall., 110, 122.

In *Park v. Johnson*, involving the same kind of note, after a statement of many facts in evidence, the court says at page 554:—

“These facts were circumstances which the jury and the court might consider and from them determine whether they were sufficient to give notice to the plaintiff or to put him on his inquiry, that the note possessed any infirmities which would in any way affect its collection. If the circumstances surrounding the purchase of the note were sufficient to give to an ordinarily prudent man notice and the plaintiff refrained from making inquiry with reference to the transaction out of which the note originated, he is not in the position of a holder in good faith without notice.” And further, “The existence of suspicious circumstances will not destroy the good faith of a transaction, but it is such circumstances as would charge the purchaser of a note, as an ordinarily prudent man, with bad faith, or notice of the infirmity in the instrument, or defect in the title of the person from whom he makes the purchase.” Now, when he is charged with notice, as stated, evidently for all legal purposes he knows, and is therefore not acting with reference to faith but knowledge; the court regarded bad faith and knowledge of the infirmity or defect as equivalent, and charging the taker means to hold him to the legal liabilities of knowledge. Here we see no statement about putting one on inquiry and the test is all the better for that omission.

In *Park v. Brandt*,<sup>70a</sup> involving the same kind of note, at page 667 the court finds the following language in a charge erroneous:—“willful ignorance of facts is as much evidence of bad faith as actual knowledge of the same,” although the language had received the sanction of the Supreme Court of the United States.<sup>71</sup> To sustain its disapproval, the court proceeds:—“What the plaintiff was required to do was to exercise such care as an ordinarily prudent man would do under like circumstances, but the mere willful ignorance of facts would not necessarily establish bad faith in the purchaser \* \* \* If the facts however are such as would lead an ordinarily prudent man to investigate, and an investigation is not made, then such failure may be taken into consideration in determining whether the purchase was made in good faith or bad faith \* \* \*,” holding that such a charge invades the province of the jury in determining the weight of the evidence. The court seems to overlook the force of the word “willful” in this statement, and the test lacks the logic and directness of the preceding case.

---

<sup>70a</sup> See note 58.

<sup>71</sup> *Murray v. Lardner and Hotchkiss v. Bank*, above.

In *Vaughn v. Johnson*" at page 676 the court again criticizes the language noted in the preceding paragraph and says:—

"He is only chargeable with facts which actually come to his knowledge. These facts may be actual knowledge of a defect in the title, want of consideration or such facts as would constitute a defense to the note as between the maker and the original payee; or actual knowledge of such facts and circumstances as would lead an honest and fair business man to make further inquiry, and which inquiry if made would lead to the discovery of the fraud, defect and defenses. In other words, it must be such actual knowledge of the defenses or such actual knowledge of facts and circumstances that a failure to make further inquiry would charge a reasonably prudent business man with bad faith and dishonest motives." How this differs from the willful ignorance criticized above is not shown by the court.

Some other cases before this court involve this question but develop no new or different views, and it is interesting to turn to the last case of the same general type<sup>76</sup> and note the reaction of the court eight years after the first case noted above, keeping in mind that this court said in an intervening case that it had gone to the very limit.<sup>76a</sup> In this last case the court reaffirms the rule laid down in the first one. The net result of the attempts of the court in these cases to give clear statement and definition to the law is a rule in which the knowledge of the taker must work two effects, namely, to put upon inquiry and to charge with bad faith, and the equivalent of bad faith is said to be dishonest dealing. The statutory rule requires only bad faith, and assuredly a trial court is not helped by an explanation of the statute which requires a jury to find two facts instead of one, the finding of neither being perceptibly helpful in ascertaining the other. In the language of a famous baseball player, such rulings do not illuminate, they obfuscate, and the multiplicity of cases appearing in an unbroken line in the reviewing courts is eloquent of the results of these and many other similarly murky opinions.

In further illustration of the difficulties involved in charging a jury in such cases the language of the court in a federal case is significant,<sup>78</sup> at page 530:—

"If the purchaser of the note has actual knowledge of the infirmity \* \* \* that ends the case. If he has no such actual knowledge, then bad faith or a willful disregard of known facts showing the

<sup>72</sup> See note 68.

<sup>76</sup> *First Natl. Bank v. Hall*, 31 Ida., 167.

<sup>76a</sup> *Burdell v. Nereson*, 28 Ida., 129, 136.

<sup>78</sup> *Re Hopper-Morgan Co.*, 156 Fed., 525.

infirmity or want of title or a willful evasion of knowledge of the facts will be sufficient to defeat recovery. Facts sufficient to create a suspicion of the truth are not sufficient to show knowledge or bad faith, nor is mere gross negligence in making inquiry or in failing to make inquiry, alone sufficient. There must be either actual knowledge or bad faith.

"Bad faith may be shown by a willful disregard of and refusal to learn the facts when available and at hand. [Copious citation of federal authorities, from *Goodman v. Simonds* down.] A person about to take a negotiable instrument can not willfully shut his eyes to information or means of information or knowledge which he knows are at hand. He cannot willfully evade knowledge which he knows or has reasonable cause to think, would show a defect in the note of want of title. He must act in good faith, not in bad faith. Circumstances may be such as to impose an active duty of inquiry and investigation and if such duty is not performed it may be conclusive evidence of bad faith; that is, the law may charge the party with knowledge which was at hand, available, and to which he shut his eyes; that is, he might have known the truth, ought to have known the truth, had good reason to suspect the truth, and did, but willfully refused to become fully acquainted with it."

The gist of the court's struggle to phrase this rule in its simplest terms is that when one is put upon inquiry he is charged with knowledge of what was to be ascertained; hence, legally, is he not in the same situation whether he inquires or not? The crucial matter in such statements of the law is—When is he put upon inquiry? The answer heard is—When it would be bad faith not to inquire; but since bad faith is the ultimate thing to be found in such cases this reasoning has taken us in a circle, and certainly some other definition must be made.

A few more crisp statements of the courts in attempting to clear up this field of the law may be noticed here:—bad faith does not involve a furtive motive;<sup>79</sup> where the maker of a note told an intending purchaser that there was fraud in its inception, although the nature of the fraud was not stated the buyer takes at his peril subject to the proof of the fraud;<sup>80</sup> proof of failure to exercise reasonable diligence and caution and proof of circumstances which would have caused a reasonably prudent man to inquire about the instrument, and proof of negligence in not pursuing inquiries, do not any or all of them, establish bad faith;<sup>81</sup> it is incorrect to charge

<sup>79</sup> *Ward v. City Trust Co.*, 192 N. Y., 61.

<sup>80</sup> *Jackson v. Jones*, 94 Ark., 426.

<sup>81</sup> *Comstock v. Hannah*, 76 Ills., 530.

that proof of knowledge of facts sufficient to put the purchaser on inquiry would support a finding of bad faith;<sup>84</sup> if the purchaser had such knowledge bearing on the fraud as to cause him to believe that it was procured by fraud, then, so far as his action in purchasing is concerned, he knew that the note was procured by fraud.<sup>85</sup>

It will be noted from this glance at the cases that the most frequently suggested test of bad faith is that the taker must have knowledge of such facts and circumstances as to put one upon inquiry. The wide currency of this test is doubtless due to its long standing use in the field of ordinary contracts; in that field however bad faith is not a necessary element to be considered in determining rights of parties where a contract has been transferred. But under the last branch of the rule in Sec. 56 under consideration, bad faith is the sole criterion, and it is difficult to see that the rule is explained by the matter of whether one is put upon inquiry or not. Suppose the inquiry could discover no infirmity; is he still acting in bad faith in failing to pursue it? Clearly not. Or, suppose that infirmity would be discovered by inquiry and the inquiry is made; the instrument would hardly be bought, or if bought it would certainly be subject to the infirmity. Or, suppose there is infirmity, and the inquiry is not made, and the instrument is bought; is he then acting in bad faith? If his failure was due to indolence or carelessness or even gross negligence, there is no bad faith. It seems that he must have a high degree of knowledge by all the authorities before he is put upon inquiry and just at that point they apply the rule that he is charged with whatever an inquiry would show, therefore it seems simpler and more logical to omit the matter of inquiry from this rule.

As suggested above the only case in which this becomes a serious question is where there is an infirmity or defect, the facts or circumstances which suggest or indicate it are known to the taker, an inquiry would uncover the infirmity or defect but it is not made—is the failure to inquire bad faith? Is the knowledge he has the disabling factor, or the failure to attempt to acquire more? Buying with the knowledge he has shows his intention to act entirely regardless of the rights of the maker and so is a piece of dishonest dealing. The buying is dishonest, not the failure to inquire; if he had inquired he would not have bought (at least it is not conceivable); it is the purchase that now makes him antagonistic to the defendant, and he will stand or fall upon the morality of his act in buying—its regard or disregard for the other's rights—his honesty or dishonesty.

---

<sup>84</sup> *Shaffer v. Bank*, 147 N. W., 851 (Iowa, 1914).

<sup>85</sup> *Link v. Jackson*, 164 Mo. App., 195; *Bank v. Borchers*, 83 Nebr., 530.

If there is any duty to inquire, logically it would attach upon suspicious circumstances known, while the duty to refrain from taking an unconscionable advantage is positive and attaches immediately upon learning of facts or circumstances which create the belief of fraud or the like, and he must be conclusively presumed to have the belief when his action in purchasing would be dishonest. It is not a matter of diligence or negligence<sup>55a</sup> in ascertaining further facts after enough facts or indications of circumstances are known to induce the belief that there is fraud; purchasing then shows a moral disregard for the right of the maker and is classed as the exercise of bad faith or dishonesty in dealing which should disable him from fastening any liability upon the maker by a transaction which must be featured by good faith to be maintainable. The use of the term "bad faith" gives a moral turn to the investigation which will support the preceding conclusions; it is not believed that the test applied in New York<sup>55b</sup> of bad faith in a "commercial sense" has been elsewhere adopted.

A virile charge where bad faith must be established will emphasize knowledge of facts which creates belief in the existence of the fraud and the like; looking at the evidence the jury should inquire—What did he know when he bought the instrument? If he did not know the specific facts of the defense did he know so much that his conduct in buying a claim against the maker was in disregard of the latter's rights? Did he nevertheless buy when he knew facts which inevitably led to the inference of fraud and the like? The jury must sound its own sense of morality and determine the honesty or dishonesty of the taker.<sup>57</sup> Although the widely varying circumstances in evidence in such cases call for diversified instructions, yet the simple question to be answered in them all is—Did he take in bad faith? And it is submitted that we are not brought nearer to an answer by considering the matters of being put upon inquiry and the reasonably prudent man, which phrases have been great malefactors in befogging the law.

The following conclusions ensue from the foregoing, and summarize the discussion:—

I.—The first branch of the rule of Sec. 56 N. I. L. has not been the subject of controversy as to its merits.

a.—In making application thereof, cases where the defect or infirmity appears upon the instrument should be placed hereunder for the taker is held to have actual knowledge of

<sup>55a</sup> *Gray v. Boyle*, 55 Wash., 578.

<sup>55b</sup> *Rochester & Co. v. Paviour*, 164 N. Y., 281.

<sup>57</sup> *Bank v. Borchers*, 83 Nebr., 530; *Murray v. Lardner*, 2 Wall., 110, 122; *Winters v. Nobs*, 19 Ida., 18, 26; *Vaughan v. Johnson*, 20 Ida., 669, 676.

whatever appears in the writing and must be held to its legal implications; the faith of the taker is not a factor.

2.—The second branch of the rule has been the subject of much controversy.

a.—This controversy in England came on in 1824 in an effort, not to change the law, but to give it more precise definition by applying the "suspicious circumstances" rule.

b.—By 1836 the controversy in England was determined by laying down the rule essentially as stated in the above Sec. 56.

c.—In the United States the "suspicious circumstances" rule was chiefly favored by the states until 1857, when the United States Supreme Court announced the rule of this Sec. 56. Thereafter the tendency in the states was towards this rule.

d.—In applying this branch of the rule the effort has been to give clearer definition to its scope; but much confusion has resulted from the application of the rule relating to putting one upon inquiry prevailing in the law of general contracts.

e.—Where one is put upon inquiry three situations must be regarded:—

(1)—Where there is no infirmity or defect; here certainly the taker's rights are exactly the same whether inquiry is made or not.

(2)—Where there is an infirmity or defect—

A—If the inquiry is made the infirmity is discovered and the taker then has actual knowledge and the first branch of the rule applies.

B—Hence the only case of interest is where the inquiry is not made; the state of the taker's mind should determine his rights. If the facts known to him are sufficient to create the belief or the unavoidable inference that an infirmity exists, his buying is dishonest dealing towards defendant. It is not the failure to inquire but the dishonest purchase which establishes the bad faith. It is agreed by those courts that insist upon the rule that the taker is "put upon inquiry" that the taker is charged with the facts discoverable by an inquiry; if so then clearly the taker's legal situation is the same with or without the inquiry.

f.—"Putting an ordinarily prudent man upon his inquiry" as a rule for the determination of the taker's rights is open to the same type of objections as drove out the rule of "suspicious circumstances."

g.—The charge to the jury should embody at least an instruction to ascertain what facts or circumstances bearing on the infirmity or defect are shown by the evidence to have been known to the taker at the time, and whether they created the belief or the unavoidable inference that the defect or infirmity existed; if so, it was dishonest to purchase this negotiable claim against the defendant and the plaintiff will fail because of his bad faith.

GEORGE W. RIGHTMIRE.

*College of Law, Ohio State University.*