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Lester W. Feezer

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PAYEE AS A HOLDER IN DUE COURSE

MAY THE PAYEE OF A NEGOTIABLE INSTRUMENT BE A HOLDER IN DUE COURSE?

By LESTER W. FEEZER*

The controversy as to whether or not, under the Uniform Negotiable Instruments Law, a payee may be a holder in due course continues to produce its grist of cases from year to year. As was said by the Tennessee court in one of the most recent cases involving the question:1 "All hope for a uniform construction of this section2 has now become vain." The problem must therefore be considered as this court suggests, by the application of the ordinary rules of statutory interpretation3 and also in the light of the requirements of commercial practice.

To reiterate the suggestion in the title, the fundamental question of law to be discussed in this paper is this: First, can a named payee in a negotiable instrument ever be a "holder in due course" within the meaning of the Uniform Negotiable Instruments Law, and by virtue of his status as such, entitled to the peculiarly favored position of the ordinary bona fide purchaser of a negotiable instrument who is not named therein? Second, if this be answered in the affirmative, are there any limitations upon the circumstances under which the payee may enjoy the benefits of being a "holder in due course" other than those affecting a holder to whom such an instrument is indorsed by the named payee? Conversely stated: Is one who satisfies, in other respects, the conditions of the Uniform Negotiable Instruments Law, particularly section 52, disqualified from being a holder in due course because he happens to be the named payee?4

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1Snyder v. McEwen, (1923) 148 Tenn. 423, 256 S. W. 434.
2Section 52 Uniform N. I. L. This section provides as follows: "A holder in due course is a holder who has taken the instrument under the following conditions:
1. That it is complete and regular upon its face;
2. That he became the holder of it before it was overdue, and without notice that it had been dishonored, if such was the fact;
3. That he took it in good faith and for value;
4. That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it."
3Snyder v. McEwen, (1923) 148 Tenn. 423, 256 S. W. 434, holds that a payee may be a holder in due course under N. I. L.
The cases involving this problem seem to be subject to classification in three groups:

1. Those which hold that the payee of a negotiable instrument may not be a holder in due course thereof, because the instrument has not been negotiated to him.⁵

2. Those which hold that a payee may be a holder in due course and which place him practically on a parity with any other holder whose name does not appear on the instrument except as incident to a transfer by indorsement.⁶

3. Those which hold that a payee may be a holder in due course where such named payee takes the instrument "from a holder (not the maker) to whom it was negotiated as a completed instrument."⁷

The present writer adopts the view that a payee of a negotiable instrument may be a holder in due course where the circumstances are otherwise such as would bring an endorsee within the definition of "holder in due course" in section 52 of the Uniform Negotiable Instruments Law. Moreover there is nothing elsewhere in the Uniform Act which opposes an insurmountable obstacle to this interpretation. The following reasons may then be given as important arguments for this view. First; The Uniform Negotiable Instruments Law may reasonably be interpreted as intending that a payee may achieve the status of holder in due course. Second; That result is in accord with the prevailing view at common law. Third; It is highly desirable that the payee should be able to qualify as a "holder in due course" because that

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⁵See also section 54, 55, 56, 59, N. I. L. for other provisions referring to circumstances affecting the holder in due course of a negotiable instrument.

⁶Among the cases frequently cited as holding that a holder in due course can be only a holder who takes by negotiation from the payee, some were decided largely upon facts involving section 14 or section 16 N. I. L. and have been qualified, or limited or distinguished in later decisions. Still others so holding do not refer in any way to the Negotiable Instruments Law and cannot be regarded as important authorities for this proposition. See Brannan, Negotiable Instruments Law, 3rd Ed., page 49 et seq. See infra text and notes 45, 46, 47, 48, and 49 for reference to authorities so holding.

⁷Outstanding among the cases so holding for the reasoning employed are probably Liberty Trust Co. v. Tilton, (1914) 217 Mass. 462, 105 N. E. 605, L. R. A. 1915B 144, and in England the opinion of Fletcher Moulton, L. J., in Lloyd's Bank v. Cooke, [1907] 1 K. B. 794, 76 L. J. K. B. 666, 23 T. L. R. 429. Other cases so holding include, Snyder v. McEwen, (1923) 148 Tenn. 423, 256 S. W. 434; Ex parte Goldberg & Lewis, (1914) 191 Ala. 356, 67 So. 839, L. R. A. 1915F 1157. See also notes 54, 55 and 56.

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position is in accord with both commercial practice and commercial convenience. Fourth; It is the view which represents the weight of authority today and is supported by what appear to be the better reasoned cases since the adoption of the Negotiable Instruments Law. Fifth; In some instances at least the maker or other party sought to be charged upon the instrument will be estopped by his conduct in connection with the execution and delivery of the instrument to deny that the payee is a "holder in due course," or, at any rate, that he is entitled to recover upon it.8

This problem has first presented itself in a number of jurisdictions complicated by circumstances calling for the determination of other questions and the application and interpretation of other provisions of the Uniform Negotiable Instruments Law, than those sections bearing strictly upon this problem of the payee's status as holder in due course. Some of the better known cases on this topic have involved instruments which were not completed by the maker and in which blanks have been filled by some intermediary party in violation of his authority or otherwise without the authority of the maker or other party sought to be charged and after the instrument has left the hands of such party or else have been the subject of an unauthorized delivery by some intermediary.9 Hence a number of these cases have involved the points dealt with in sections 14 and 16 of the Uniform Act and sometimes also involve questions relative to the nature and extent of the agency of such intermediary.10

Prof. Underhill Moore has pointed out at some length that in connection with the problems of the nature dealt with in this discussion both the American Negotiable Instruments Law and the British Bills of Exchange Act treat these problems from the

8Lloyd's Bank v. Cooke, [1907] 1 K. B. 794, 76 L. J. K. B. 666, 96 L. T. 715, 23 T. L. R. 429; Peoples State Bank v. Snyder, (N. D. 1924) 195 N. W. 436; Security Bank v. Foster, (Tex. 1923) 249 S. W. 227, states that payee herein is and may be a holder in due course even though the intermediary delivered the instrument in violation of his authority from the makers, but that it is immaterial whether he be a holder in due course or not as he is protected by estoppel, citing Lloyd's Bank v. Cooke, [1907] 1 K. B. 794, 76 L. J. K. B. 666, 96 L. T. 715, 23 T. L. R. 429.
9Empire Trust Co. v. Bank of Manhattan Co., (1916) 97 N. Y. Misc. 694, 162 N. Y. S. 629, wherein it was held that the payee was not the holder in due course of an instrument which he took in good faith and for value from a thief, on the ground that the instrument had not been completed by delivery with the drawer's intent that it should take effect as a completed and negotiable instrument. This case is criticized, 1 MINNESOTA LAW REVIEW 446, 30 HARV. L. REV. 515, 17 COL. L. REV. 566.
10The questions of agency which may be involved in this problem are discussed by Prof. Moore in the article cited, viz., at 20 Col. L. Rev. 749.
standpoint of the innocent (stranger) purchaser and do not treat of the payee's claim or of the remitter and his rights. Prof. Moore believes that at least the bona fide purchaser from the apparent owner of true remittable paper, for example, bank drafts, whether he be payee or indorsee, should be protected as a holder in due course. But Prof. Moore would limit this protection to cases of what he considers true remittable paper, including bank drafts and such other instruments as are extensively remitted. He would not include checks. This view would apparently establish a more restricted classification than the third one referred to above in some respects; but, if the instrument be true "remittable paper" the payee would be treated as well as any other holder in due course and would come within the second of the classifications referred to.

At common law it was the general rule that the payee of a negotiable bill of exchange or promissory note could be a holder thereof in due course if he acquired the instrument before maturity, in good faith, for value and without notice of defenses available to the maker, acceptor, drawer or irregular indorser, as against the intermediary or remitter from whose hands he received it.

"The remitter most common is one who has purchased or borrowed a bill or note payable to someone else, with the assent of the drawer, maker, acceptor or irregular indorser in order that the remitter may use it for his own benefit." Moore, 20 Col. L. Rev. 749.

"It does not seem to the present writer that the protection of a payee of a negotiable instrument as a holder in due course should be made to depend upon the instrument being of the sort extensively used for remitting. The extent of the custom of remitting personal checks is a variable quantity in different localities but it is extremely common and seems to be growing, at least in the middle west. The number of cases in which the question of the payee's rights has come even before courts of last resort for determination serves to illustrate the frequency and variety of circumstances in which checks are so used. But it is the argument of this paper that the rights of the payee need not be sustained merely on the ground that the particular instrument in which he is interested is of a type customarily used for remitting payments between debtor and creditor. Indeed the bona-fide-purchasers-payees of promissory notes, which of course are not at all frequently used for this purpose are treated as holders in due course in some of the leading cases on this side of the controversy. Bank of Commerce v. Randell, (1921) 107 Neb. 332, 186 N. W. 70, 21 A. L. R. 1365; Ex parte Goldberg & Lewis, (1914) 191 Ala. 356, 67 So. 839, L. R. A. 1915F 1157; Liberty Trust Co. v. Tilton, (1914) 217 Mass. 462, 105 N. E. 605, L. R. A. 1915B 144. As to checks in this connection see particularly Boston Steel & Iron Co. v. Steuer, (1903) 183 Mass. 140, 66 N. E. 646.

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Under the modern statutes codifying the law merchant, this point seems to have been judicially referred to in England for the first time in Lewis v. Clay, in which case Lord Russell of Killowen said by way of dictum, "A 'holder in due course' is a person to whom, after its completion by, and as between the immediate parties, the bill or note has been negotiated." This dictum then at least infers that delivery between original or immediate parties is not negotiation. The question was first fairly presented in England however, in Herdman v. Wheeler in 1902. This case is the source to which must be traced the view now so extensively established in this country. In this case the defendant, the Rev. Mr. Wheeler, having arranged with one A to secure a loan for him, signed and gave to A a blank form with authority to fill it up as a note for £15. A, in violation of this authority, fraudulently filled up the paper as a promissory note for £30, inserting plaintiff's name as payee. A then sold the note to the plaintiff, who gave value for it in good faith and without notice that it had been signed in blank. A then misappropriated the proceeds. It was held that the delivery of the note by A to the plaintiff was not a negotiation within the meaning of section 20, subsection 2, of the Bills of Exchange Act so as to entitle plaintiff to recover.

Herdman v. Wheeler involves the abuse of authority to fill blanks, by the person intrusted with the instrument by the maker, but in this case the note was filled out and was complete on its face before it came to the notice of the plaintiff. Therefore, if plaintiff was, in other respects, a holder in due course, he was not disqualified from enforcing it for the full amount under the provisions of section 14 of the Negotiable Instruments Law or section 20 of the British Act. In Herdman v. Wheeler the court said that it was not holding that a payee could never be a holder in due course and added that it was unnecessary to decide that point. In this connection the court says; "Even if the payee may be a holder in due course, the question whether he is, depends


Sec. 14, N. I. L.

upon the actual state of facts as between him and the maker.” The rest of the opinion does not altogether satisfy one as to what facts were present in the case to bring it within the application of the above quoted statement, nor why the court found it necessary to express its regret, that to hold the other way would strain the meaning of the words “negotiate” and “issue” as used in the statute. The case has been the subject to some criticism, not only in contradictory decisions but in reviewer’s notes and text book comments involving this point.19

The question next arose in England in Lloyd’s Bank v. Cooke in 1907, the result of which was contrary to Herdman v. Wheeler.20 The principal opinion in this case attempted to distinguish Herdman v. Wheeler on the ground that in Lloyd’s Bank v. Cooke the defendant was estopped to deny to the plaintiff, who was bona fide purchaser-payee, the intermediary’s authority to fill up the blank as it was filled up when it reached the plaintiff. Lord Justice Fletcher-Moulton, however, in his concurring opinion baldly disagrees with Herdman v. Wheeler, saying that the view expressed in that case involves taking the position that it was the intent of the Bills of Exchange Act to change the well settled rule at common law. At least two other English cases are of some importance in this connection; Smith v. Prosser,21 in which the estoppel rule as laid down in Lloyd’s Bank v. Cooke was held not to apply in circumstances where there was never a delivery of the instrument with intent that it take effect as a negotiable instrument. In this case the maker left two blank signed note forms with his agent to be filled out and issued only upon his sending specific instruc-

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20[1907] 1 K. B. 794, 76 L. J. K. B. 666, 96 L. T. 715, 23 T. L. R. 429. The defendant had signed his name on a piece of blank stamped paper and had entrusted the paper to another person with authority to fill it up as a promissory note for a specified amount payable to plaintiff as security for an advance made by plaintiff in the form of an overdraft. The person to whom it was so entrusted filled it up for a larger amount and obtained the larger amount from the plaintiff who had no notice of the fraud. The court in resting its decision on the ground of estoppel said that the doctrine of estoppel had not been affected in its application to such facts as these, either by the Bills of Exchange Act or by the decision in Herdman v. Wheeler.
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The maker then went abroad, and the agent without any such instructions filled up the notes and sold them for value to plaintiff after inserting plaintiff's name as payee. Plaintiff acted in good faith but it was held that estoppel did not apply in his favor here because there never was a negotiable instrument of the defendants' making in existence, since there had been no authority to issue any at all and, that, as the plaintiff knew of the agency status of the person from whom he purchased the notes, he was chargeable with notice as to the limits of his authority. It is submitted that this last circumstance controls the situation as matter of agency and notice without laying down any rule of general application in the law of negotiable instruments.

*Talbot v. Boris* indirectly involved the question of payee as holder in due course. In applying the British equivalent of section 59, sub-section 1 of the Negotiable Instruments Law relative to the burden of showing that the plaintiff is a holder in due course it was held that this question was not applicable to a case where the instrument was in the hands of the person to whom issued.

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23 *Awde v. Dixon*, (1851) 6 Exch. 869, 20 L. J. Ex. 295, 17 L. T. O. S. 189; *Empire Trust Co. v. Bank of Manhattan Co.*, (1916) 97 N. Y. Misc. 694, 162 N. Y. S. 629 discussed in note 9; See also *Apostoloff v. Levy*, (N. Y. 1918) 170 N. Y. S. 930. In this latter case plaintiff drew a check payable to order of the defendant, a stock broker, and handed it to a third party with instructions to deliver it to defendant as margin on a certain short sale. The third party delivered it to the defendant on a transaction of his own and later received from defendants the amount standing to his credit on a short sale which he directed them to make on his own account. Held: the third party had no apparent title to the check and for that reason the brokers were liable to the plaintiff. See also *Hathaway v. Delaware Co.*, (1906) 185 N. Y. 368, 373, 78 N. E. 153. The case also cites one of the earlier Nebraska cases holding that a payee could not be a holder in due course, viz. *Camp v. Sturtevant*, (1884) 16 Neb. 693, 21 N. W. 449. See also, *Eliason State Bank v. Montevideo Baseball Ass'n*, (Minn., 1924) 200 N. W. 300.

24 *Watson v. Russell* (1864), 3 B. & S. 34 are discussed by Mr. A. M. Hamilton in 24 Juridical Review 41. In this article Mr. Hamilton takes the position of Herdman v. Wheeler and concludes that under both common law and the Bills of Exchange Act the view that a payee cannot be, or at least is not a holder in due course

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Section 59, N. I. L. clause 1, “Every holder is deemed prima facie to be a holder in due course but when it is shown that the title of any person who has negotiated the instrument was defective, the burden is on the holder to prove that he or some person under whom he claims acquired the title as holder in due course.” Compare Bills of Exchange Act, section 30 (2) “But if in an action on a bill it is admitted or proved that the acceptance, issue or subsequent negotiation of the bill is affected with fraud, duress or force or fear or illegality, the burden of proof is shifted, unless and until the holder proves that, subsequent to the alleged fraud or illegality, value has in good faith been given for the bill.”

The cases above referred to and *Watson v. Russell* (1864), 3 B. & S. 34 are discussed by Mr. A. M. Hamilton in 24 Juridical Review 41. In this article Mr. Hamilton takes the position of Herdman v. Wheeler and concludes that under both common law and the Bills of Exchange Act the view that a payee cannot be, or at least is not a holder in due course
In the light of the few decisions under the British Bills of Exchange Act, some writers express the view that the English law is uncertain as to whether a payee can be a holder in due course, others appear to be satisfied that the effect of *Lloyd’s Bank v. Cooke* is to establish the rule that the payee may be a holder in due course.

The American cases are in irreconcilable conflict, although certain jurisdictions have repeatedly asserted one view or the other so that the law may be regarded as settled in those particular states. As has already been stated, these cases may be classified in two or possibly three groups. At common law, in this country as in England, the generally accepted view was that a payee of a negotiable instrument might be a holder in due course.

The only jurisdiction having clear decisions to the contrary, prior to the adoption of the Negotiable Instruments Law, was Nebraska. That jurisdiction, however, in construing the uniform law has announced the view that a payee is a holder in due course, where is the better one. He says: "The relation between immediate parties is simply one of contract. [See page 111 this article.] It is difficult to see why a different principle should be applied when the person professing to act, say for the maker of a note, happens to be not an ordinary agent but a person desiring accommodation, an agent ‘ad hoc’ proposing to make money by his wits, or some other interested party, or when the agent is entrusted with the completing of the bill."

This reasoning is of course a repetition of part of the reasoning in *Herdman v. Wheeler* in which case the court approved the argument of counsel that as between the original parties to it, the note is governed by the ordinary law of contracts other than the law merchant and hence that the element of negotiability does not enter into the case-as between maker and payee. That this involves putting the payee of a non-negotiable instrument in a better position than the payee of one which is negotiable is pointed out in the footnote on page 345, Norton, Bills and Notes 4th Ed.


"For collections of authorities to date thereof see Annotation at 15 American Law Reports 437 and 21 A. L. R. 1365; Brannan, The Neg. Inst. Law, 3rd Ed., 51 et seq.

The authorities are also very fully collected in a number of the cases. See among the more recent containing a particularly full collection and discussion of the cases in point: Am. Nat. Bank v. Kerley, (1923) 109 Ore. 155, 220 Pac. 116.


he has taken the instrument from a holder, not the maker, to whom it was negotiated as a completed instrument.\(^3\)

The leading American case holding that a payee may not be a holder in due course under the statute is Vander Ploeg v. Van Zuuk.\(^4\) This case was decided in Iowa in 1907 on the authority of Herdman v. Wheeler.\(^5\) This case was decided in the same year as Lloyd's Bank v. Cooke\(^6\) and evidently without the latter case having been brought to the court's attention.\(^7\) In the Vander Ploeg Case as in both Herdman v. Wheeler and Lloyd's Bank v. Cooke, the situation was complicated by the fact that the instrument left the hands of the party sought to be charged, with blanks unfilled. Hence, under section 14 of the Uniform Negotiable Instruments Law, the purchaser to achieve the status of holder in due course (whether he be payee or not) must have acquired the instrument only after it was filled up or he is charged with notice of the nature and extent of the authority of the intermediary party from whom he acquired it.\(^8\) This is true of any purchaser who takes the instrument while incomplete whether he be the named payee or an indorsee.\(^9\) In the Iowa case the court first tells us that we have the simple case of a note wrongfully filled out and delivered to the payee who is without notice of the wrongdoing.\(^10\) It is pointed out that the question is governed by section 14 of the uniform act and that plaintiff is entitled to recover if he is holder in due course. Later in the opinion the court says plaintiff is not a holder in due course because he did not get the instrument by negotiation as required by section 52. Still later we are told

\(^{3}\)This of course involves the adoption of the broader meaning of the word "negotiated" in the N. I. L. Or at least admits that the reference to negotiation by indorsement in section 30 N. I. L. must be regarded as defining a way but not necessarily the only way in which such an instrument may be negotiated.


\(^{8}\)Boston Steel and Iron Co. v. Stuer, (1903) 183 Mass. 140, 66 N.E. 646. This case reviewed 15 Harv. L. Rev. 596.


\(^{10}\)In Vander Ploeg v. Van Zuuk, (1907) 135 Ia. 350, 112 N. W. 807, 13 L. R. A. (N. S.) 490, the payee did not acquire or see the instrument until the blanks had been filled and had no notice that it had left the hands of the defendant while incomplete.
that the real reason which led the court to this decision was the change in the law, effected by the uniform statute under the provisions (not of section 52) of section 14. In other words we have this inconsistent line of reasoning: First, section 14 will not prevent plaintiff from recovering if he is a holder in due course. Second he is not a holder in due course because of section 52 (which by the way is not accused of changing the common law rule at all). Third and last, plaintiff could have recovered at common law but cannot under section 14 because Lord Russell said so in his dictum in *Lewis v. Clay.*

The Iowa case does not say that a payee can never be a holder in due course, and in fact suggests that he might be so in some cases, but it does after all put the decision on the ground that the plaintiff took the instrument, although he was a bona fide purchaser under section 14, not by "negotiation" but by delivery to him as the named payee. This case thinks that the payee of a complete bank draft acquiring it for value from the remitter may be a holder in due course, delivery having taken place when the remitter got it from the bank and negotiation when the remitter sold it to the payee. In short here we have the dictum for the third classification already referred to, and followed in the Nebraska case of *Bank of Commerce v. Randell.*

It seems to the writer that nothing of importance has been added to the argument of *Herdman v. Wheeler* and *Vander Ploeg v. Van Zuuk* by other cases taking that position and those which do so hold are after all driven to the necessity of resting their conclusion upon the construction which shall be placed upon the single word "negotiated" as used in section 52 of the Uniform act.

Section 14 of the Uniform Negotiable Instruments Law does change the law to the extent that it requires the purchaser of a negotiable instrument with an unfilled blank to inquire as to the nature and extent of the authority of the intermediate party who was intrusted with the instrument in this form,* but it makes no distinction between payees and other bona-fide purchasers, and, where such purchaser acquires it after it is filled up, he has the usual rights of a holder in due course. The trouble arises over the word "negotiated," but the presence and meaning of the word in this section would not have caused this trouble if the misconcep-

*See note 39.*
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tion of Lewis v. Clay had not been in the books. But the Iowa court having this misconception in mind devised an argument, with the aid of Herdman v. Wheeler to sustain it, and, having this precedent before them, other courts have taken it as a basis for the extreme view entirely excluding the payee from the possibility of being a holder in due course.

Herdman v. Wheeler and the Iowa case both use language relative to the situation between immediate parties being governed by the law of simple contract and make the argument apply to the payee in his dealing with the maker, drawer, acceptor, or indorser. This argument is evidently adverted to as a prop to sustain a reading of the statute which was naturally somewhat repugnant to an inherent sense of equity. Even so it is beside the point for three reasons; in the first place it was not the rule prior to the adoption of the modern statutes; secondly, the negotiability of an instrument having been established, it is not, strictly speaking, governed by the law of simple contract at all. The law of simple contract has always been the law of the common law courts, the king's courts. The law of negotiable instruments on the other hand is the law merchant. Since its adoption into the common law system, to be sure, its basic principles have been somewhat colored by mixing with them such common-law doctrines as "consideration," "the parol evidence rule" and "estoppel," but on the whole the unique principles of the law merchant have been preserved; thirdly the parties are not necessarily immediate unless they are made so by the very interpretation of the word "negotiated" which is the point in question; they were not so regarded prior to the statute, and hence to call them so is begging the question.44

Several states seem to have committed themselves to the Iowa interpretation of the term "negotiated" at least, and one or two have apparently given this interpretation the extreme effect of completely excluding the payee from the status of holder in due course. These states are Iowa,45 Kentucky,46 Missouri,47 Okla-

44"In the final analysis this difference of judicial opinion arises from the different constructions placed upon the word "negotiated" in section 7844 Oregon Laws (section 52, N. I. L.) when taken in connection with other sections of the statute." American National Bank v. Kerley, (1923) 109 Ore. 155, 220 Pac. 116, 126.
homa and South Dakota. Nebraska has adopted the intermediate position which already has been referred to and which was suggested in *Vander Ploeg v. Van Zutik*. One case in Oregon and one in Washington have been read and referred to by some as sustaining the broad proposition that a payee may not be a holder in due course but both of these cases have been limited if not overruled in their respective jurisdictions by later decisions clearly holding that a payee may be a holder in due course.

80, 85, 198 S. W. 543; *First Nat. Bank v. Utterback*, (1917) 177 Ky. 76, 197 S. W. 534, L. R. A. 1915B 838.


*First Nat. Bank v. Allen*, (1923) 88 Okla. 162, 212 Pac. 597. Former cashier of bank had defaulted. Defendants were his relatives. A third party, as agent for the bank, (according to the finding of the court below) procured the defendants to execute the note in suit in order to save their relative, the defaulted cashier, from criminal prosecution. Held the bank is not a holder in due course. The supreme court says, "we are doubtful whether the record sustains the finding that Patton was the bank's agent, but it does not follow that the judgment should be reversed." The court proceeds to find that the plaintiff bank gave no consideration for the note and hence states that even if as payee the bank could be a holder in due course, it was not such in this case because of the lack of consideration. Elsewhere in its opinion however the court flatly declares that the payee as such cannot be a holder in due course.

From what has been said it will be apparent that the statement that a payee cannot be a holder in due course is purely dictum. However in a later case of *Strother v. Wilkinson*, (1923) 90 Okla. 247, 216 Pac. 436, this court relying on the above holds that a payee as such is not capable of being a holder in due course, and hence approves the admission of evidence as to transactions between original parties of which plaintiff had no notice. These cases were followed as conclusive authority upon the Oklahoma court in *Rice et al v. Jones*, (Okla. 1924) 225 Pac. 958.


See note 32.

*Bank of Gresham v. Walsh*, (1915) 76 Ore. 272, 147 Pac. 534.


*American National Bank v. Kerley*, (1923) 109 Ore. 155, 220 Pac. 116, holds that a payee may be a holder in due course and while the facts did not necessarily involve the application of this rule in the same situation as was involved in *Liberty Trust Co. v. Tilton*, (1914) 217 Mass. 462, 105 N. E. 605, L. R. A. 1915B 144, the court strongly approves that case. The opinion in this case points out that *Gresham v. Walsh*, (1915) 76 Ore. 272, 147 Pac. 534, does not hold that a payee cannot be a holder in due course but simply that he was not in that case because the remitter had such knowledge of defenses as to destroy that character and this remitter was the agent of the payee bank which was consequently affected with notice through him.

In *Washington in State Bank of Connell v. Pac. Grain Co.*, (1923) 125 Wash. 149, 215 Pac. 350, the plaintiff bank was held to be the holder in due course of a draft in which it was named as payee where it had acquired the instrument as a bona fide purchaser.

In *Ladd & Tilton Bank v. Small*, (1923) 126 Wash. 8, 216 Pac. 862,
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Opposed to this narrower view are Massachusetts, Pennsylvania, New York, Alabama, Illinois, Tennessee, Idaho, Vermont and Montana.

Editors and writers seem to be agreed for the most part that a payee of a negotiable instrument should be regarded as eligible to the status of holder in due course, if he qualifies in other respects and they appear to regard this view as representing not only the better reasoning but the weight of authority and even in those cases where the instrument left the maker in incomplete form and was fraudulently filled up by the intermediate party before being sold to the payee as was the case in all of the cases heretofore described in detail, including Herdman v. Wheeler, Lloyd's Bank v. Cooke and Vander Ploeg v. Van Zuuk. Prof. Chaffee says:

"The payee seems a holder in due course in such a situation (viz.: where section 52 N. I. L. is otherwise satisfied) and should

the court said that the payee of a check was not a holder in due course under the statute but the case cannot be cited for the proposition that a payee is not in due course as the remark by the court to this effect was entirely obiter and the decision was for the payee, he having proved that he bought the instrument without notice.


"Ex parte Goldberg & Lewis, (1914) 191 Ala. 356, 67 So. 839, L. R. A. 1915F 1157.

"Drumm Construction Co. v. Forbes, (1922) 305 Ill. 303, 137 N. E. 225.


"Redfield v. Wells, (1918) 31 Ida. 415, 173 Pac. 640, but see Consolidated Wagon Co. v. Housman, (Idaho 1923) 221 Pac. 143 where the note was indorsed in blank by defendant and filled out contrary to instructions held following Vander Ploeg v. Van Zuuk that payee could not be holder in due course. Redfield v. Wells was not cited.


"Other cases to this effect will be found referred to in Brannan, The Negotiable Instruments Law, 49-56.

In Minnesota this question has apparently not been adjudicated but see note in 6 Minnesota Law Review 405, where it is stated that the Minnesota court has assumed in State Bank v. Missia, (1920) 144 Minn. 410, 175 N. W. 614, that the named payee might be a holder in due course, although in the case cited the named payee failed to establish that he had acted in good faith. See also Security Bank v. Foster, (Tex. 1923) 249 S. W. 227.

be protected as much as an indorsee. Pennsylvania has recently so held in accordance with the weight of authority.5

Prof. Brannan also takes this view,6 carefully analyzing a number of the stronger cases on both sides of the controversy. He has furthermore helpfully pointed out that several of the cases sometimes cited as applying the rule unfavorable to the payee do not refer to the Uniform Negotiable Instruments Law or were actually decided on other grounds.

There are a number of notes in the legal periodicals dealing with some of the principles of law involved in this problem. These notes are especially valuable for the analysis of the particular cases reviewed and for their collection of authorities in particular states.7

On the other hand an elaborate note in American Law Reports68 disagreeing with the case to which it is appended69 concludes that, "... the weight of authority is quite evenly divided" and proceeds to express the opinion that "a logical construction of the Negotiable Instruments Law supports the conclusion reached by those courts which hold that a payee cannot be a holder in due course." A later note appears in American Law Reports70 which in a degree retracts the broad statement above quoted and asserts:

"The true criterion of a decision as to the right of the payee of a negotiable instrument to recover of the maker thereof, free from defenses the maker had against other parties to the transaction out of which the note arose, is to view the transaction as a whole, and if the payee is an innocent person who has parted with a consideration on the faith of the note, he is entitled to hold it free from equities which the maker has against other parties to the transaction."

In short this editor has arrived at exactly the same conclusion as Lord Justice Fletcher-Moulton did in Lloyd's Bank v. Cooke,

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6See reference in note 63 above.
710 Cal. L. Rev. 413; 17 Col. L. Rev. 566; 15 Harv. L. Rev. 579; 15 Id. 596; 30 Id. 515; 32 Id. 855; 26 Id. 951; 20 Mich. L. Rev. 908; 21 Id. 591; 1 Minnesota Law Review 446; 6 Id. 156; 6 Id. 406; 64 U. Pa. L. Rev. 318; 70 Id. 52.
8The above are among the more valuable of the notes of this character which have been consulted in connection with the preparation of this article.
915 A. L. R. 437.
0Merchants National Bank of Billings v. Smith, (1921) 59 Mont. 280, 196 Pac. 523.
121 A. L. R. 1365.
and the leading American cases which support the payee, and by his device of calling this payee "an innocent person who has parted with consideration, etc.,” has avoided admitting in terms that he is a holder in due course.

The various encyclopedic texts touch upon this question in a very limited fashion, but far better collections of the authorities will be found in Brannan on Negotiable Instruments and in the annotations above referred to.\(^7\)

Probably the strongest American authorities for the proposition that a payee may be a holder in due course under the Uniform Negotiable Instruments Law are the well known Massachusetts cases of Boston Steel and Iron Co. v. Steuer,\(^1\) and Liberty Trust Co. v. Tilton,\(^2\) The Steuer Case was decided in 1903, the year after Herdman v. Wheeler,\(^3\) which was cited in the opinion but not followed. The drawer of the check in this case handed it to her husband to be delivered to the payee in payment of a debt owed by her to the payee. The husband fraudulently delivered it as payment of a debt which he himself owed to the payee. The payee took it as such in good faith. It was held that the payee was a holder in due course of this check which was completed before it was offered to the plaintiff-payee. The Massachusetts court discussed but refused to follow Herdman v. Wheeler and expressly stated that the plaintiff was a holder in due course under section 52 of the uniform act (section 69 in the Massachusetts statute).

\(^3\) R. C. L. 1031, under the section heading "What constitutes holding in due course": "The fact that a person is the payee of a negotiable security does not prevent him from becoming a bona fide purchaser of it at common law, with all the rights incident to a purchaser for value without notice," citing in this connection Boston Steel and Iron Co. v. Steuer, (1903) 183 Mass. 140, 66 N. E. 646, a case clearly holding that a payee could be a holder in due course under the N. I. L. This passage proceeds in the same tenor citing two cases prior to N. I. L. and then proceeds to say: "But the term 'holder in due course' as employed in the Negotiable Instruments Law should be construed to apply only to one who takes the instrument by negotiation from another who is the holder, it should not be held to include the person to whom the instrument is made payable." The only case cited as authority for this statement is Vander Ploeg v. Van Zuuk, (1907) 135 Ia. 350, 112 N. W. 807, 13 L. R. A. (N.S.) 490.

This question is however fairly satisfactorily dealt with in the R. C. L. supplement Vol. I, page 950. At S Corpus Juris 468 the subject is referred to in the text and dealt with somewhat more fully in the notes pages 468-70.

\(^1\) (1903) 183 Mass. 140, 66 N. E. 646, 91 A. S. R. 426.

\(^2\) (1914) 217 Mass. 462, 105 N. E. 605, L. R. A. 1915B 144.

\(^3\) (1902) 1 K. B. 361, 71 L. J. K. B. 270, 86 L. T. 48, 18 T. L. R. 190, 50 W. R. 300.
This case stood as the leading exponent of its doctrine until 1914 when the rule was reiterated in Massachusetts in Liberty Trust Co. v. Tilton, in which the opinion much more fully discussed the application and meaning of the various sections of the Negotiable Instrument Law involved in a full consideration of the problem both in connection with instruments which left the hands of the maker in complete form and where, as was the fact in the principal case, the instrument was fraudulently completed between the time it left the maker and the time it was offered to the plaintiff as payee. This case presents what is probably the best reasoned opinion to be found on this point and one which is cited and quoted at length in many of the subsequent decisions.

It is not the writer's purpose to go into great detail in stating the line of reasoning followed in the cases holding that a payee may be a holder in due course even of an instrument which was incomplete when it left the hands of the maker drawer acceptor or irregular indorser. This reasoning which seems to the writer unanswerable, is reiterated in the cases and will be found most admirably set forth by Prof. Brannan.75

Briefly this line of reasoning may be summarized as involving three primary steps:

1. The word "negotiated," as used in the last sentence of section 52 of the Uniform Act and also in section 14, does not necessarily mean indorsement only but may include transfer or issue of the instrument to any person who is otherwise a holder in due course for the purpose of investing him with the absolute right to hold, retransfer or collect the same.

2. The provisions of section 30 (N. I. L.) particularly the last sentence, describe a method, but not necessarily the only method by which negotiation may be accomplished.

3. Section 59 (N. I. L.) wherein it is stated, that every holder is deemed prima facie "to be a holder in due course," taken together with section 191, which defines "holder," as either "payee or indorsee in possession" clearly indicates it to be the intent of the act, taken as a whole, that a payee should be regarded as a potential holder in due course and therefore entitled to the same protection as any other holder who qualifies as such in other respects under the provisions of section 52.

Two of the more recent cases on the problem which have re-

75Brannan, The Negotiable Instruments Law, pages 49-56 and 162.
PAYEE AS A HOLDER IN DUE COURSE

ceived some attention are Bank of Commerce v. Randell," already referred to, and Britton Milling Co. v. Williams," decided in South Dakota in 1921. The Nebraska case following the dictum in Vander Ploeg v. Van Zuuk," which is referred to in the opinion almost with veneration, takes the position that a holder payee "may be a holder in due course under the particular and limited circumstances stipulated in the opinion, and referred to as the third of the classifications mentioned earlier in this discussion, namely, that such payee has taken the instrument "from a holder (not the maker) to whom it was negotiated as a completed instrument." In short, the payee who receives a bank draft from a purchasing remitter in the ordinary way, is a holder in due course, and so, likewise, is any payee who gets the instrument under these ordinary circumstances. Under this doctrine which is essentially the ground left to the payee to stand upon by the dicta in the Vander Ploeg Case and in Herdman v. Wheeler, a bona-fide-purchaser-payee is safe only where the paper itself has nothing shady in its past. In other words the payee is charged with responsibility for the secret history of the instrument in respect to such matters as are dealt with in sections 14 and 16 of the Negotiable Instruments Law. If the instrument was incomplete when it left the hands of the principal obligor, then the payee is not a holder in due course, not because he has failed to give value or acted in bad faith or knows anything about this, but merely because he is the payee; likewise if the instrument was complete but was delivered without authority the payee, merely because he is such, comes within the defense afforded by the first part of section 16 but not within the reservation in favor of holders in due course in the latter part of the section.

Britton Milling Co. v. Williams" was decided in South Dakota in 1921 on facts essentially similar to those involved in the Nebraska case and which in Nebraska or, if we may trust the dictum in the Vander Ploeg Case, even in Iowa, would have permitted the payee to recover. However it would seem that South Dakota is committed unqualifiedly to the proposition that a payee can never be a holder in due course, because he does not take the instrument by negotiation. And in South Dakota the word is taken in its narrow meaning as quite synonymous with "endorsement."

"(1922) 107 Neb. 332, 186 N. W. 70, 21 A. L. R. 1365.
In the Nebraska case the defendant made a note payable to the plaintiff in payment for certain shares of stock which defendant purchased from one McClaran and the note was in complete form delivered by the defendant to McClaran who thereafter sold it to the plaintiff bank, presumably for value, in good faith and without notice of McClaran's fraud which the defendant now asserts. The court held that plaintiff as payee might nevertheless be a holder in due course under the Negotiable Instruments Law and following the interpretation of the word "negotiated" as suggested in *Liberty Trust Co. v. Tilton*.

In the South Dakota case the defendant gave a note for the purchase of stock in a corporation which was organized to take over the plaintiff's business, but made the note payable to the plaintiff which received it from the corporation in good faith for value and before maturity in part payment for the business. Plaintiff sued the defendant, who set up as a defense fraud on the part of the corporation's agent in connection with the sale of the stock for which the note was given. Held, plaintiff cannot be a holder in due course because the note was not negotiated to him and hence he cannot recover.

Nebraska was the one state which prior to the adoption of the uniform law had clearly taken the position that a payee, because of his character as such, could not be a holder in due course. As pointed out in the comment on this case in the Michigan Law Review, it is gratifying at least for the sake of uniformity to see Nebraska adopting the prevailing view. This review seems to overlook the extent of the limitation which the Nebraska court puts upon the broader rule of such cases as *Liberty Trust Co. v. Tilton* in situations involving section 14 of the Negotiable Instruments Law where the instrument left the hands of the party sought to be charged still containing blanks which were later fraudulently filled or tampered with before reaching the payee. The same limitation would apply to instruments delivered without the authority of the obligor sought to be charged. In other words the Nebraska case only decides in favor of the payee because he has

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80(1914) 217 Mass. 462, 105 N. E. 605, L. R. A. 1915B 144.
81See reference to these cases in note 31.
8220 Mich. L. Rev. 908.
83In truth all the "pre-statute" cases in Nebraska were cases of incomplete or technically undelivered instruments and Nebraska has not by the more recent decision changed the law at all so far as it had been announced in connection with facts involved in the earlier cases.
got an instrument which was completed and delivered by the maker, and by dictum indicated that it would follow *Vander Ploeg v. Van Zuuk* under similar facts. The court says in the course of its opinion:

“Pothoven (in the *Vander Ploeg Case*) was not the bearer of a completed note. Under the law merchant the plaintiff would have been a holder in due course. The Negotiable Instruments Law has changed the law in this respect, as it deals with completed instruments only.”

The South Dakota court, on the other hand, having no local precedents, followed the language of *Herdman v. Wheeler* and *Vander Ploeg v. Van Zuuk* and decided against the payee merely because he had not taken the instrument by negotiation, employing the word negotiation in the limited sense of meaning endorsement. The effect of the South Dakota decision therefore is that the payee of a negotiable instrument cannot be a holder in due course under any circumstances. In short “the South Dakota case has followed the general rule of the Iowa case but overlooked the exception there made of a case on all fours with the facts of *Britton Milling Co. v. Williams*.”

The Nebraska court referred to *Britton Milling Co. v. Williams* but dismissed it with the comment that it is “based on a misunderstanding of the Iowa case and also the *Herdman Case* cited therein and is contrary to the weight of authority.”

There is however something to be said for the correctness of the decision in *Britton Milling Co. v. Williams*, something which, so far as the writer has been able to discover, has been overlooked by the South Dakota Court in both the *Britton Milling Co. Case* and in *Tripp State Bank v. Jerke* which followed it, as well as by all the critics who have commented upon the decision. The Uniform Negotiable Instruments Law was adopted in South Dakota with certain modifications of the uniform draft. There is in the light of these variations, at least the suggestion that the South Dakota court has effectively, if perhaps unconsciously, voiced the intent of the local legislature.

Instead of adopting section 14 of the uniform act, the legislature of South Dakota substituted the following:

“One who makes himself a party to an instrument intended to
be negotiable, but which is left wholly or partly in blank for the purpose of filling afterwards is liable upon the instrument to an \textit{indorsee} thereof in due course, in whatsoever manner and at whatsoever time it may be filled, so long as it remains negotiable in form."

It will be noticed that South Dakota has by this wording evidently retained the American doctrine which existed prior to the Uniform Negotiable Instruments Law relative to the authority of the due course \textit{holder} of a negotiable instrument to fill blanks, but by very express language has limited that power to a particular kind of due course holder, namely an \textit{indorsee}.

Again in section 16 of the uniform act, as adopted in South Dakota, the third paragraph beginning with the word "but" and ending with the word "presumed" is omitted and the following sentence is substituted:88

"An \textit{endorsee} of a negotiable instrument in due course acquires an absolute title thereto, so that it is valid in his hands, notwithstanding any provision of law making it generally void or voidable, and notwithstanding any defect in the title of the person from whom he acquired it."

Here is the language, in these two sections, in which the South Dakota statute defines what are probably the highest rights of the most favored owner of a negotiable instrument. That language is in clear terms applicable only to an "endorsee." The legislature has deliberately and designedly altered the wording of the uniform draft of the Negotiable Instruments Law and has substituted other wording expressive of the law as it was intended to be in South Dakota.

It follows that, at least so far as concerns paper which left the obligor while incomplete, or which was delivered without authority, the "holder" who is to enjoy the special protection accorded to bona-fide purchasers of commercial paper is the "endorsee" only and not every "holder in due course."

This statute then virtually enacts the doctrine of \textit{Vander Ploeg v. Van Zuuk} and the rule which would probably be followed in Nebraska in dealing with incomplete or fraudulently delivered instruments since the decision in \textit{Bank of Commerce v. Randell}. Hence even though \textit{Britton Milling Co. v. Williams} had been decided the other way, the statute would have required the South Dakota court to follow \textit{Vander Ploeg v. Van Zuuk} upon its facts.

It is reasonable to surmise that to the South Dakota court, used to dealing with the above peculiar local provision of the statute

\footnote{S. D. Revised Code 1919, section 1720.}
governing negotiable instruments, a holder in due course seemed so palpably an "endorsee" only, that it was taken for granted. It is to be regretted that, if the court arrived at its decision in Britton Milling Co. v. Williams on this basis, the opinion did not so state. Without this explanation the cases of Britton Milling Co. v. Williams and Tripp State Bank v. Jerke\(^8\) cannot be explained at all, and, even with this special local legislation in mind, it is to be questioned whether the use of the word "indorsee" in the way in which it is used in sections 14 and 16 of the Negotiable Instruments Law as it now stands in the statutes of South Dakota, makes it fair to infer that the same limited meaning must be given to the expression "holder in due course" where it occurs elsewhere in the act and where South Dakota has not departed from the uniform draft.

The importance, from the standpoint of commercial expediency, of holding that a payee may be a holder in due course is apparent and this advantage has been pointed out in many decisions, particularly among the more recent ones. One notices that the law is favorable to the payee in those states in which are located the greatest financial and commercial centers of the country; those cities where the vast volume of commercial-paper transactions take place and in which are found the great reservoirs of credit supplying the market which takes up negotiable instruments originating in the more purely agricultural or industrial communities and exceeding the sum of local banking power available for their absorption. In Iowa, or South Dakota or Nebraska, the majority of the credit operations involving the transfer of commercial instruments are probably carried out between farmers and local banks. The parties involved are to a large degree familiar with each other's business affairs, or at all events can inform themselves without serious loss of time or great inconvenience. The local banker to whom is offered an instrument for discount can more readily find out all about the transactions connected with its execution and delivery and its subsequent history, than can the banker or wholesale merchant in a great city whose accounts contain hundreds of names in many states. This difference in point of view has to some extent, although perhaps unconsciously, reflected itself in the private opinions of the bench and bar, in a jurisdiction where either the one or the other of these conditions exists, and ultimately this attitude of the legal profession becomes crystallized in the form of a judicial utterance.

\(^8\)(1922) 45 S. D. 448, 187 N. W. 314.