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BILLS AND NOTES — BONDS PAYABLE AT OFFICE OF TRUSTEE WHICH BECOMES INSOLVENT AFTER DUE DATE BUT BEFORE BONDS PRESENTED — In *Morley v. University of Detroit*,[1] decided May 16, 1933, the Supreme Court of Michigan reaches a conclusion not only of intense interest as a matter of legal doctrine, but also tremendously important, if followed, in determining the location of losses that may run into large sums. The defendant had floated a large bond issue secured by trust mortgage to a Trust Company. Among the obligor's undertakings in the mortgage was one to the effect that it would punctually pay the principal and interest of every bond according to the terms of the bond and coupons and would "deposit the necessary funds for such purpose with the trustee at least five days prior to the respective due dates." [2] The defendant obligor had made the required deposit of funds with the trustee, but plaintiff who held certain bonds and coupons which such deposit was intended to cover failed to present them at the due date. The Trust Company shortly thereafter closed its

[1] 263 Mich. 126, 248 N. W. 570 (1933).
[2] No part of the mortgage deed is quoted in the opinion.

doors, and the case developed as a claim by the holder of such bonds and coupons against the obligor for the full amount thereof. The court denied the claim, the bonds and coupons being deemed paid.

Since *Wallace v. McConnell*[3] there has been but little doubt in the American courts that in an action against the maker of a note or the acceptor of a bill made payable at a certain place it was unnecessary to allege, or prove, that the instrument had been presented for payment at the designated place. The fixing of a place for payment does not make the promise to pay a conditional one. The United States Supreme Court in that case pointed out that failure to make such presentment at the agreed place at maturity was matter of defense for the defendant. But such failure would not afford a general defense to the action; it would mean exoneration "from all costs and damages."[4] Thus at least some of the effects of a tender would be produced by the debtor having the money at the right place at the right time.[5] The doctrine of the *Wallace* case is embodied in the Uniform Negotiable Instruments Law in Sec. 70, which declares that

> "Presentment for payment is not necessary in order to charge the person primarily liable on the instrument; but if the instrument is, by its terms, payable at a special place, and he is able and willing to pay it there at maturity, such ability and willingness are equivalent to a tender of payment upon his part."

Before the N. I. L., the cases were conflicting as to the effect of the provision in a note or accepted bill making it payable at a bank; also as to the incidence of the loss in case the money was on deposit at the bank at the appointed time and the bank failed thereafter before the presentment of the instrument for payment. The former question apparently was set at rest by Sec. 87.[6]

In *Lazier v. Horan*[7] a maker of a note payable at a certain bank

[3] 13 Pet. (38 U. S.) 136, 10 L. ed. 95 (1839). See also Stevens v. Berkshire Street Ry., 247 Mass. 399, 142 N. E. 59 (1924), where held, bondholder could sue obligor without having presented bond to trust company where bonds were payable.

[4] See also Moore v. Altom, 196 Ala. 158, 71 So. 681 (1916).

[5] The extent to which the presence of the necessary funds is to be treated as a tender is not wholly clear. It is a matter of doubt, for example, whether under the authorities it is a tender so as to discharge sureties and other parties not primarily liable. See such cases as Franklin Savings and Trust Co. v. Clark, 283 Pa. 212, 129 Atl. 56 (1925); Farmers' State Bank v. Kvamme, 50 N. D. 549, 197 N. W. 143 (1924); Appleman v. Pepis, 117 Okla. 199, 246 Pac. 225 (1926); Corley v. French, 154 Tenn. 672, 294 S. W. 513 (1927).

[6] "Where the instrument is made payable at a bank it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon."

The question was elaborately considered, before the N. I. L., in Grissom v. Commercial Nat. Bank, 87 Tenn. 350, 10 S. W. 774, 3 L. R. A. 273, 10 Am. St. Rep. 669 (1889).

[7] 55 Iowa 75, 7 N. W. 457 (1880).

deposited the necessary money there to take up the note. The holder omitted to present the note at the due date and for some time thereafter, and the bank failed. In concluding that the loss fell upon the holder the court relied upon text writers and certain dicta and what it deemed the implications of certain decisions, confessing that it had found no authorities "which are fairly in point." The question, however, was fully re-examined by the same court in a later case,[8] with the conclusion that "a careful examination of the authorities shows that the case of *Lazier v. Horan* is almost alone in holding that payment of the amount due on a promissory note to the bank designated therein as the place of payment, at the maturity of the note, will be effectual as a payment of it." The court repudiated the suggestion that the designation of a bank as the place of payment in any sense constituted such bank the agent of the holder to receive payment.[9]

Since the N. I. L., it has been urged that by putting together two provisions therein the loss in case of insolvency of the bank should fall upon the non-presenting holder. Under Sec. 87[10] it is now clear that the instrument payable at the bank is "equivalent to an order," and by Sec. 186 it is declared that "a check must be presented for payment within a reasonable time," otherwise the drawer will be discharged from liability "to the extent of the loss caused by the delay." There can be no doubt now that banks are permitted to treat paper there payable as checks; but does it follow that holders of such instruments must treat them as checks? If the answer is in the affirmative, then the makers and acceptors, whose liability is unmistakably primary, undergo a curious metamorphosis and they become parties with only secondary liability. In several cases, since the N. I. L., it has been held that the provision of Sec. 186 does not effect a release of the maker or acceptor, in whole or in part.[11]

[8] Bank of Montreal v. Ingerson, 105 Iowa 349, 75 N. W. 351 (1898). In this case many cases both before and after the Lazier case are considered.

[9] See also Caldwell v. Evans, 5 Bush. (Ky.) 380 (1869); St. Paul Nat. Bank v. Cannon, 46 Minn. 95, 48 N. W. 526 (1891); Hills v. Place, 48 N. Y. 520 (1872). "Unless the banker has been made the agent of the holder by the endorsement of the paper or the deposit of it for collection, any money which the banker receives to apply in payment of it will be deemed to have been taken by him as agent of the payor." Adams v. Hackensack Improvement Com'n, 44 N. J. Law 638 at 647 (1882). See Pease v. Warren, 29 Mich. 9 (1874); Trowbridge v. Ross, 105 Mich. 598, 63 N. W. 534 (1895); Bloomer v. Dau, 122 Mich. 522, 81 N. W. 331 (1899).

[10] Supra, n. 6.

[11] Cosmopolitan Trust Co. v. Leonard Watch Co., 249 Mass. 14, 143 N. E. 827 (1924); Adler v. Interstate Trust and Banking Co., (Miss. 1933) 146 So. 107; First Nat. Bank v. Redding, 121 Neb. 642, 237 N. W. 669 (1931); Federal Intermediate Credit Bank v. Epstin, 151 S. C. 67, 148 S. E. 713 (1929); Binghampton Pharmacy v. First Nat. Bank, 131 Tenn. 711, 176 S. W. 1038, 2 A. L. R. 1377 (1915).

Cases in Kansas and New York cast a bit of doubt upon the position taken in the

The Michigan court in its recent decision concedes the soundness and controlling effect of doctrines such as those above stated. The case then under consideration is differentiated on the ground that the bonds in question were "trust mortgage bonds payable through the agency of a trustee." The court said:[12]

> "In a large bond issue such as this, it would be impossible for the mortgagor to deal directly with its many bondholders. That is the business of a trustee. These bonds on their face informed the holders that they were dealing with the maker through a trustee appointed for their benefit. It is generally known by those who invest in this class of securities that it is the duty of a trustee to receive payments from the mortgagor and distribute them among the bondholders; and that the trustee does not hold the mortgage as security for a debt owing to himself but holds it for the bondholders. . . . From these recitals and references it appears that the bonds are of an issue aggregating $2,400,000 secured by a single trust mortgage given to the Fidelity Trust Company of Detroit, as trustee; that in payment of the principal and interest the mortgagor is required to deposit with the trustee five days before maturity sufficient money for that purpose, and, if it fails to do so, the trustee, acting for the bondholders, may accelerate all payments and enforce collection. These provisions relative to default of the mortgagor became a part of the bond by reference. . . . "

It was pointed out that these provisions of the mortgage and bonds constituted the holder's contract with the mortgagor and the trustee and showed the conditions agreed to by the holder when he purchased; that the authority of the trustee to receive payments and distribute them is thus shown; that the mortgagor had made the deposit with the trustee as agreed and thus had done all it was required to do; that it could not have reclaimed the money so paid; and that the Trust Company thereupon held the deposit as trustee and agent for the bondholders. The court cites no authority.

Negotiable instruments are discharged by "payment in due course by or on behalf of the principal debtor."[13] Payment "in due course" is effected when made "at or after the maturity of the instrument to

cases just cited. The New England Nat. Bank v. Dick, 84 Kan. 252, 114 Pac. 378 (1911); Baldwin's Bank of Penn Yan v. Smith, 215 N. Y. 76, 109 N. E. 138 (1915). As to the latter case the court in Cosmopolitan Trust Co. v. Leonard Watch Co., 249 Mass. 14 at 23, 143 N. E. 827 (1924), said, "The case . . . contains some reasoning in conflict with this conclusion, but as it is stated in the opinion that it is unnecessary to decide the question, it cannot be considered as an authority opposed to the decision we have reached."

[12] Morley v. University of Detroit, 263 Mich. 126 at 128, 248 N. W. 570 (1933).

[13] N. I. L. §119-1.

the holder thereof in good faith and without notice that his title is defective."[14] By "holder" is meant the "payee or indorsee . . . who is in possession of it, or the bearer thereof."[15] That payment to the agent of the holder is effective is clear. But the agency to receive payment must be established by proof the burden of which is upon the one relying on the agency. The fact that the paper is payable at a specified bank does not constitute such bank an agent to receive payment.[16] Nor is the trustee or mortgagee in the security deed as such an agent to receive payment.[17]

The soundness of the conclusion in the principal case, then, turns upon whether the Trust Company, the trustee in the trust deed and at whose office the maturing bonds and coupons were made payable, was affirmatively and specifically constituted the agent of the bondholders to receive payment. The court unfortunately fails to set forth the terms of the trust deed which it relies upon as showing the agency. The opinion indicates that chief reliance was upon the covenant by the debtor-mortgagor to deposit with the trustee five days before maturity sufficient money to cover the principal and interest about to mature and the further provision that in case of failure so to do, the trustee, acting for the bondholders, "may accelerate all payments and enforce collection."

In a bond or note issue intended for general sale it is, of course,

[14] N. I. L. §88.

[15] N. I. L. §191.

[16] The court in the principal case concedes this to be true, citing: Trowbridge v. Ross, 105 Mich. 598, 63 N. W. 534 (1895); Bloomer v. Dau, 122 Mich. 522, 81 N. W. 331 (1899); Adams v. Hackensack Improvement Com'n, 44 N. J. Law 638 (1882). See also Whalen v. Vallier, 46 Idaho 181, 266 Pac. 1089 (1928); Wood v. Swan, 206 Iowa 1198, 221 N. W. 791 (1928).

[17] In speaking of a trustee the court in Miller v. Mitchell, 58 W. Va. 431 at 437, 52 S. E. 478 (1905), said: "As trustee, he had only such powers as are conferred upon him by statute, and by the terms of the instrument creating the trust, and the power to receive payment of the trust debt is not included in them."

In Connell v. Kaukauna, 164 Wis. 471 at 496, 159 N. W. 927 (1917), Rosenberry, J., said:

> "It is the established law of this state that payment of a negotiable instrument must be made to the party having possession of the same or to some person duly authorized by the payee to accept payment, and that where the person to whom payment is made is not in possession of the negotiable instrument the burden is upon the party making the payment to show the agent's authority by clear and satisfactory evidence. . . . The authority of the trustee to act for the bondholders is prescribed and limited by the terms of the trust deed, and a payment to the trustee merely as trustee cannot be held to be payment to the bondholders, unless made when and as prescribed by the terms of the deed."

See also 2 PERRY ON TRUSTS, 7th ed., secs. 602 g., 602 l. (1929); Winkel v. Haning, 264 Ill. App. 231 (1931); Kennell v. Herbert, 342 Ill. 464, 174 N. E. 558 (1930).

highly desirable from the debtor's point of view that some definite, locatable person be agreed upon as a representative of the indefinite creditors. The securing mortgage of necessity runs to a specified mortgagee or trustee for the protection of the note- or bond-holders. As to the security there can be no question that the trustee represents the holders, and as such representative he has various powers to affect their interests. However, as shown by many cases, some of which are cited herein, he is not authorized to represent the creditors, aside from matters affecting the security, merely by virtue of his position as trustee or mortgagee. He must be specially authorized, as said by Judge Rosenberry, "by clear and satisfactory evidence."

The covenant by the mortgagor to deposit the necessary funds with the trustee five days ahead of the maturity date would seem to fall far short of an appointment of the trustee by the bondholders (by buying bonds containing reference to the trust deed) as their agent.[18] The provision giving the trustee power, in case of default in making such deposits, to accelerate the maturity and to proceed to collection,[19] either standing alone or in conjunction with the covenant to deposit, also seems a slender foundation for finding an agency for the reception of payments generally.

Whatever may be said as to the terms of the trust deed being dictated by the financing agency, the fact remains that its execution by the debtor makes the language therein more truly that of the debtor than of the bondholders. He has ample opportunity to insist on the presence of provisions establishing an agency that will amply protect him. There is no reason for him to leave such an important point as this to construction of doubtful terms. Besides, the trustee is normally chosen by the debtor. At least it is not the bondholders who select him. Other things being equal, there seems to be reason to cast the risk of honesty and solvency upon those who make the selection. These observations merely fortify the point suggested above that while a court should not refuse to find an agency by the trustee for the creditors to receive pay-

[18] The insolvency and closing of the Trust Company came not during the five-day period but later. If the failure had occurred during that period a very interesting question would have arisen. It is a fair inference from the court's treatment of the Trust Company as the bondholders' agent in receiving payments that the resulting loss in such event would fall on them. Since under the circumstances here the creditors until the due date could have no possible claim to the money, such result would be rather remarkable. The possibility at least suggests again that the agency of the trustee should be established only by unmistakable language.

[19] This provision was never called into operation. In this connection Andrews v. Missouri State Life Ins. Co., (C. C. A. 5th, 1932) 61 F. (2d) 452, becomes particularly significant. In that case the court considered the language of the mortgage sufficient to create an agency in a certain contingency; but that did not mean that the trustee was the creditor's agent as to payments except under the contingency stated. See n. 23, infra.

ment, it should do so only on the basis of clear language leading to that result.

In *Manchester v. Sullivan*[20] the Connecticut court concluded that the trustee in the trust deed then before the court was constituted the agent of the creditors. As a consequence it was held that a loss due to the insolvency of the trustee fell upon those creditors rather than upon the debtor. The conclusion, however, was based upon language[21] not referred to by the court as in the deed in the Michigan case. On the other hand, in *Adler v. Interstate Trust and Banking Co.*[22] the Mississippi court could not find appropriate language in the mortgage to constitute the trustee an agent to receive payment binding upon the note holders.

Most striking of all, however, is *Andrews v. Missouri State Life Ins. Co.*[23] The case arose out of a claim by the holder of certain coupons, representing interest payments on bonds secured by a trust mortgage, against the obligor personally. The defense was that the trustee, which had failed, had in its hands at the due date of the coupons, which was before the failure of the trustee, the necessary funds to pay them. It was contended that the bank (trustee) held the money "as the agent and trustee of the bondholders, and that its possession of it on (the due date) operated as payment of the coupons." As to the money for the retirement of the coupons the mortgage contained a covenant by the debtor "That she will deposit with the Trustees at the Bank of Tennessee at Nashville, Tenn., at least thirty days prior to the date when the semi-annual interest payments are due, a sum equal to the semi-annual interest to be paid . . . " (with a like provision for any matured principal). The court concluded that the language did not make the money in the hands of the trustee payment. In reaching this conclusion the court emphasized the fact that in the mortgage in dealing with the final defeasance and in redemption before maturity obvious care had been taken to spell out in unmistakable language that

[20] 112 Conn. 223, 152 Atl. 134 (1930).

[21] "Upon the payment of all of said notes, or the deposit with said trustee of the face value of said notes with accrued interest, said trustee may give a proper quitclaim deed releasing this mortgage and all the property herein described from the obligation thereof." Manchester v. Sullivan, 112 Conn. 223 at 226, 152 Atl. 134 (1930). See also Goodfellow v. Stillwell, 73 Mo. 17 (1880).

[22] (Miss. 1933) 146 So. 107. The language relied upon for the creation of the agency was in the form of a provision for payment at the debtor's option in advance of maturity. The mortgage provided that this might be effectuated "upon payment of all accrued interest to date of payment, and a premium of one and one-half per cent of the amount so paid, having first given to the (trustee) sixty days previous written notice of their intention so to do." The court concluded that "notice to the (trustee) did not constitute that company the agent of (the holders) to receive payment of the notes."

[23] (C. C. A. 5th, 1932) 61 F. (2d) 452 (1932).

depositing funds with the trustee should be deemed to amount to complete satisfaction of the obligor's liabilities.[24]

Tested by the principles which both reason and authority seem to establish it is at least doubtful whether the court in the case under consideration was not a bit too ready to fasten upon the bondholders an agency in the Trust Company.[25]

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[24] The defeasance clause is quoted by the court as follows (p. 454):

"Provided, however, and these presents are on the express condition that if Leontine C. Andrews . . . shall well and truly pay or cause to be paid to the holders of bonds to be issued hereunder when the same shall become due and payable *the whole amount* of principal and interest due upon *all* the bonds and coupons hereby secured and then outstanding . . . or shall provide for such payment by *depositing with the Trustees* hereunder for the payment of such bonds and coupons *the entire amount* to be paid thereon, principal and interest . . . then the said Trustees shall reconvey the property herein described to said Leontine C. Andrews, etc."

The redemption clause is quoted as follows:

"If such notice shall have been so given, published and mailed, and such deposit made (with the corporate Trustee), the bond or bonds so called for redemption shall be considered redeemed and shall *be payable upon such redemption date at the office of the corporate Trustee* and no further interest shall accrue upon any such notes called for redemption, and any coupons for interest maturing after such date shall be wholly null and void, and such notes and coupons *shall cease to be obligations* of the party of the first part, or be entitled to any further right or benefit hereunder, and the owner or holders thereof *shall look for payment solely and only to said deposit* in the hands of the corporate Trustee, anything in such notes or coupons or herein to the contrary notwithstanding." *Ibid.*

[25] Normally the note or bond contains none of the language of agency, if any is to be found anywhere; that is part of the mortgage which the individual investor rarely sees, though reference thereto is made in the note or bond. In the principal case the bonds contained a reference clause which the court says made the mortgage provisions as to default a part of the bond as follows: "In case of certain events of default specified in the mortgage, the principal of this bond may be declared or may become due and payable prior to its regular maturity in the manner and with the effect provided in the mortgage." It should be observed here that courts have gone to great lengths in the effort to hold bonds negotiable in construing language therein as affecting *only rights on the security*. Reference need be made only to Enoch v. Brandon, 249 N. Y. 263, 164 N. E. 45 (1928); Paepcke v. Paine, 253 Mich. 636, 235 N. W. 871, 75 A. L. R. 1205 (1931); Pflueger v. Broadway Trust and Sav. Bank, 351 Ill. 170, 184 N. E. 318 (1932). See 31 MICH. L. REV. 984 at 985. (1933). In the principal case the court unhesitatingly declared the bonds negotiable.

Except for those special instances in which one may become an agent as a mere legal device to accomplish a certain result, agency is a matter of appointment. If one is to be deemed to have appointed an agent by becoming an owner of a note or bond referring probably in general terms to a security deed which contains the language of appointment, which deed the creditor has probably never seen, it would seem a minimum of safeguard to require that the language should be unmistakable.