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Bills and Notes - Indorsements - Effect of Contemporaneous Agreement on the Indorsement Contract

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RECENT DECISIONS

BILLS AND NOTES—INDORSEMENTS—EFFECT OF CONTEMPORANEOUS AGREEMENT ON THE INDORSEMENT CONTRACT—Plaintiff, payee of a promissory note, indorsed and negotiated the note to the defendant bank. Attached to the note was a separate agreement of assignment and warranty in which the plaintiff assigned the note and a conditional sales contract to defendant, and further agreed to repurchase the note if any of the warranties in the contemporaneous agreement were breached. The maker of the note defaulted and defendant, after due presentment and notice, debited plaintiff's account for the face amount of the note. Plaintiff brought suit to recover the money from defendant on the theory that the contemporaneous agreement had qualified the general indorsement contract implied by statute from his signature on the note.¹ The trial court held that the plaintiff was an unqualified indorser and gave judgment for defendant. On appeal, *held*, affirmed. While the indorsement of the note and the contemporaneous agreement should be construed as one contract, the language of assignment in the contemporaneous agreement is not sufficient to make plaintiff a qualified indorser.² *Allison Ford Sales v. Farmers State Bank*, (Iowa 1957) 86 N.W. (2d) 896.

The general rule of contract law, that contemporaneous instruments which relate to the same transaction will be construed as a single contract,³ has often forced the question whether a bill or note is rendered non-negotiable by a separate agreement such as a mortgage or conditional sales contract.⁴ There are, however, very few cases dealing with the effect of the contemporaneous instrument rule on the general indorsement contract

¹ The separate agreement read in part: "For value received, the undersigned hereby sells, assigns and transfers . . . the note herein referred to." This language was relied on by plaintiff as a qualification of his special indorsement on the note. He contended that the words of assignment were similar to the words "without recourse" which under Iowa Code (1954) §541.38 (NIL, §38) would be a qualified indorsement. He also contended that the specific assumption of the assignor's liability in the contemporaneous agreement negated the general indorser's liability imposed by statute under Iowa Code (1954) §541.63 (NIL, §63).

² The court quite properly follows the better view in holding that words of assignment (even when written on the back of a note) do not create a qualified indorsement, nor do they relieve the indorser from the statutory liabilities of a general indorser under Iowa Code (1954) §541.66 (NIL, §66). For a general background and discussion of this branch of the case, see *Fay v. Witte*, 262 N.Y. 215, 186 N.E. 678 (1933). See also BRITTON, *BILLS AND NOTES* §58 (1943); Arant, "The Written Aspect of Indorsement," 34 *YALE L. J.* 144 (1924).

³ 3 WILLISTON, *CONTRACTS*, rev. ed., §628 (1936).

⁴ The better view is that a negotiable instrument and a contemporaneous agreement will not be construed as one contract unless the bill or note requires one to look at the separate agreement to determine its terms, in which event the bill or note is rendered non-negotiable. *Enoch v. Brandon*, 249 N.Y. 263, 164 N.E. 45 (1928). See generally Aigler, "Conditions in Bills and Notes," 26 *MICH. L. REV.* 471 (1928).

implied by statute from a blank or special indorsement on a bill or note.⁵ The courts which have decided the point assume that the contemporaneous agreement should be construed as part of the indorsement contract.⁶ Thus if the indorser signs a note in blank, but in a contemporaneous agreement assigns to the indorsee without recourse, he will be deemed a qualified indorser despite his blank indorsement on the back of the note.⁷ The courts have used caution in applying this rule by insisting that the contemporaneous agreement must contain definite language which clearly indicates that the indorsement on the note is to be modified.⁸ Thus phrases in contemporaneous agreements such as "we sign the note for the security of money,"⁹ and "this (note) is given as a full settlement of the claim,"¹⁰ have been held not to qualify the indorsement contract. The court in the principal case, by holding that words of assignment in a contemporaneous instrument do not qualify the indorsement contract, displays the caution found in these cases. It is also generally held that the contemporaneous agreement cannot protect the indorser from unqualified indorsement liability against the holder in due course who has no knowledge of the separate agreement.¹¹ A few courts have held that a contemporaneous agreement will not vary the legal import of the indorsement when there is specific writing on the note which shows the type of indorsement contract that the indorser intended.¹² Although these latter decisions are of little value in the great majority of cases because most indorsements do not spell out their legal effect, they do show a slight judicial dissatisfaction with the contemporaneous instrument rule in the setting of the indorsement contract.¹³ It seems somewhat anomalous that it is generally held that a con-

⁵ The indorsement contract implied by the statute is that an indorser of a negotiable instrument engages to pay the holder if the maker or acceptor defaults and due presentment, notice and protest are properly given. NIL, §66.

⁶ *Davis v. Brown*, 94 U.S. 423 (1876), is the leading American case for the rule that contemporaneous agreements can modify the indorsement contract. The courts have generally followed this rule since the enactment of the NIL. See *Gillett v. Flora*, 68 Colo. 218, 187 P. 527 (1920); *Blackwood v. Sakwinski*, 221 Mich. 464, 191 N.W. 207 (1922); *Title Insurance & Trust Co. v. Bandini*, 26 Cal. App. (2d) 157, 79 P. (2d) 141 (1938); *Home State Bank of Russell v. Milberger*, 146 Kan. 541, 72 P. (2d) 1004 (1937).

⁷ Although most of the cases in this area involve qualified indorsements, it has been held that a contemporaneous agreement can render indorsements conditional as well as qualified. See *Richmond Postal Credit Union v. Booker*, 170 Va. 129, 195 S.E. 663 (1938).

⁸ *Crilly v. Gallice*, (3d Cir. 1906) 148 F. 835; *Byers v. Appleman*, 50 Ohio App. 135, 197 N.E. 595 (1935).

⁹ *First Nat. Bank of Louisville v. Bickel*, 154 Ky. 11, 156 S.W. 859 (1913).

¹⁰ *Byers v. Appleman*, note 8 supra.

¹¹ *Wood v. Ferguson*, 71 Mont. 540, 230 P. 592 (1924); *Davis v. Brown*, note 6 supra.

¹² See *Hawkeye Securities Fire Ins. Co. v. Central Trust of Des Moines*, 208 Iowa 573, 221 N.W. 486 (1929); *Central State Bank of Dallas v. First State Bank of Abilene*, (Tex. Civ. App. 1925) 276 S.W. 941.

¹³ Several other courts have also indicated some dissatisfaction with the contemporaneous instrument rule as applied to indorsement contracts. See *Jones v. Commercial*

temporaneous agreement will be read as part of the indorsement contract when the majority of the courts refuse to read the conditions of a contemporaneous agreement into the body of a negotiable instrument.¹⁴ This majority rule is based on the sound theory that the terms of a negotiable instrument are unconditional promises or orders found on the face of the bill or note; therefore, if contemporaneous instruments were read as one contract with the body of the bill or note, negotiability would usually be destroyed.¹⁵ When, however, a contemporaneous agreement is read as part of the indorsement contract it will usually merely qualify the indorsement rather than destroy negotiability.¹⁶ Thus since the strong policy in favor of negotiability does not work against the contemporaneous instrument rule in the setting of indorsement contracts, the courts have not felt a need to object to the application of this contract rule to indorsements. It is submitted, however, that it would be more in keeping with the concept of integrity of negotiable instruments not to apply the contemporaneous instrument rule even to indorsement contracts. The indorsement contract fixed by statute is an integral part of a negotiable instrument and should not be construed according to a general rule of contract law.¹⁷ From a practical viewpoint, the main advantage of this approach would be in avoiding problems, like the one in the principal case, of determining whether ambiguous words used in the contemporaneous agreement are sufficiently technical to qualify the indorsement even if they had been used on the note instead of in the separate instrument.¹⁸ The separate agreement might still be used solely as a defense in a suit between the immediate parties, but not as a modification of the indorsement contract. If the separate agreement were used solely in defense there would only be the question of whether the parties clearly intended to relieve the indorser from his liability on the note, instead of the current practice of changing the import of the indorsement contract according to the tenor of the language in the contemporaneous agreement.

W. Stanley Walch

Credit Co., 52 Ga. App. 796, 184 S.E. 652 (1936); *Byers v. Appleman*, note 8 supra; and *Crilly v. Gallice*, note 8 supra.

¹⁴ See note 4 supra.

¹⁵ BRITTON, BILLS AND NOTES §15 (1943).

¹⁶ NIL, §38 provides that a bill or note is still negotiable even when it has been qualifiedly indorsed. In *Lutz v. Matheny*, 208 Ill. App. 40 (1917), the court held that a contemporaneous agreement could modify the indorsement contract, but it could not reduce the indorser's liability to less than that of a qualified indorser.

¹⁷ The principal case takes note of the strong statutory implication in favor of the unqualified indorsement contract, but still applies the contemporaneous instrument rule.

¹⁸ See note 2 supra for a discussion of the effect of words of assignment on the indorsement contract.