Michigan Law Review

Volume 53 | Issue 6

1955

Bills and Notes - Holder in Due Course - Notice of Infirmity in Instrument to Finance Company Closely Connected to Dealer

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RECENT DECISIONS

BILLS AND NOTES—HOLDER IN DUE COURSE—NOTICE OF INFIRMITY IN INSTRUMENT TO FINANCE COMPANY CLOSELY CONNECTED TO DEALER—The defendant purchased a car from a dealer who represented it to be a new demonstrator. In fact, the car was a used one. The defendant executed a negotiable note for the balance of the purchase price and a chattel mortgage on forms which were furnished the dealer by the plaintiff finance company. The dealer handled the paper, but the plaintiff was to finance the sale and the note was payable at the office of the plaintiff. Both the bill of sale and the chattel mortgage described the car as a new demonstrator. The note was indorsed in blank by the dealer and, along with the bill of sale and the chattel mortgage, was sent to the office of the finance company. Prior to the receipt of the certificate of title from the state, the finance company paid the dealer for the note. The title showed that the car was used and the defendant refused to pay further instalments. On appeal from a judgment for plaintiff, *held,* reversed. The plaintiff did not qualify as a holder in due course because it had actual knowledge of the infirmities in the instrument.[1] Since the plaintiff was not a holder in due course, it was bound by the same equities that existed between the defendant-maker and the dealer-payee and could not recover on the negotiable note. *General Motors Acceptance Corp. v. Daigle,* (La. 1954) 72 S. (2d) 319.

Financial credit arrangements play an important role in stimulating modern retail business, but in many instances the retailer cannot afford to assume the burden of a financier. Thus many retailers have understanding with finance companies whereby the latter provide the necessary blank forms and agree to purchase the note upon completion of the sale by the retailer. Assuming that

[1] Although the opinion is not entirely clear, it appears that the court found actual notice for two reasons: (1) the plaintiff financed the arrangement by which the dealer obtained possession of the car from the factory, and (2) the plaintiff held both the chattel mortgage and the title, which, when viewed together, demonstrated the misdescription of the car by the dealer. First, notice in the past which is forgotten at the time of the purchase of the instrument may not deprive the purchaser of the status of holder in due course. See BRITTON, BILLS AND NOTES §107 (1943). Second, the finance company paid for the note before the title arrived. The court said that a statute prevented the sale of the car from being complete until the title arrived. [La. Rev. Stat. (Supp. 1950) §32:706.] The court reasoned that the transaction was not complete so that the finance company could not be a holder in due course until the title was in the hands of the company, and the title gave notice of the defects in the instrument. The statute requires the instrument to be "complete and regular upon its face" before the purchaser can claim to be a holder in due course. [Uniform Negotiable Instruments Law §52(1), enacted by La. Rev. Stat. (1950) §7:52(1).] It would seem that the court confused the requirement that the title arrive for the sale of the car to be complete with the requirement that the instrument be complete for the holder to qualify as a holder in due course. The sale of the car by the dealer should not affect the decision of whether the finance company purchased the note as a holder in due course. The sale of the car and the sale of the note are two separate transactions. See BRITTON, BILLS AND NOTES §113 (1943).

the note is negotiable,[2] the question arises whether the finance company can qualify as a holder in due course of the note.[3] The holder having that status is not subject to the personal defenses which exist among the prior parties.[4] However, to qualify for that advantageous position, the holder must take the instrument in good faith without notice of any infirmities.[5] It has been held that a finance company may receive the protection of a holder in due course despite its prior close relationship with the seller.[6] On the other hand, the modern tendency is to deny the finance company this favored status.[7] The general attitude is that the "close connection" between the retailer and the finance company should prevent the latter from receiving any special protection, and such a decision frequently is justified by finding actual or constructive notice of the defect.[8] In the past, Louisiana expressly rejected the argument that the close connection is sufficient to defeat the presumption that the purchaser of the instrument was a holder in due course,[9] but the principal case takes a step in the direction of the modern trend despite its affirmation of the earlier decision.[10] The principal case may be explained on traditional grounds since actual knowledge of infirmities, of course, precludes one from becoming a holder in due course.[11] But the attitude is a warning to finance companies closely

[2] A question of negotiability may arise. See State National Bank of El Paso, Texas v. Cantrell, 47 N.M. 389, 143 P. (2d) 592 (1943); Von Nordheim v. Cornelius, 129 Neb. 719, 262 N.W. 832 (1935). For other problems which may arise, see 152 A.L.R. 1222 (1944).

[3] For a collection of cases see 128 A.L.R. 729 (1940).

[4] NIL §57 [enacted by La. Rev. Stat. (1950) §7:57]. See also BRITTON, BILLS AND NOTES §125 (1943).

[5] "A holder in due course is a holder who has taken the instrument under the following conditions: . . . (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." NIL §52. See also 8 AM. JUR., Bills and Notes §§383, 386, 400 (1937); 10 C.J.S., Bills and Notes §§321, 323, 330(d) (1938); BRITTON, BILLS AND NOTES §§100, 101, 108 (1943).

[6] White System of New Orleans, Inc. v. Hall, 219 La. 440, 53 S. (2d) 227 (1951). See also International Finance Co. v. Magilansky, 105 Pa. Super. 309, 161 A. 613 (1932); Mayer v. American Finance Corp., 172 Okla. 419, 45 P. (2d) 497 (1935).

[7] Illustrative of the cases are Commercial Credit Corp. v. Orange County Machine Works, 34 Cal. (2d) 766, 214 P. (2d) 819 (1950); Mutual Finance Co. v. Martin, (Fla. 1953) 63 S. (2d) 649; Wilson v. Gorden, (D.C. Mun. App. 1952) 91 A. (2d) 329; Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W. (2d) 260 (1940). For additional cases see 128 A.L.R. 729 (1940).

[8] See cases cited in note 7 supra. The courts feel that the finance company should not be able to use the NIL as a shield to obtain an unfair advantage over the maker of the note.

[9] White System of New Orleans, Inc. v. Hall, note 6 supra. The principal case cites this decision with approval, but holds that the finance company had actual notice and could not qualify as a holder in due course. Note the presumption created in favor of the holder by NIL §59. See also BRITTON, BILLS AND NOTES §102 (1943).

[10] See cases cited in note 7 supra, where the decision is often justified by finding actual or constructive notice. See also Taylor v. Atlas Security Co., 213 Mo. App. 282, 249 S.W. 746 (1923).

[11] See note 5 supra.

related to retailers that the courts will scrutinize their financial transactions and will not hesitate to protect the purchaser from unscrupulous dealers through finding actual notice of the defect at the slightest provocation.[12] How much further the law reasonably should be extended to include cases where no such actual notice exists in fact is a problem of public policy. The innocent purchaser's grievance is justifiable where the finance company is closely connected to the wrongdoing dealer,[13] but the policy of encouragement of credit sales to further the national prosperity calls for assurances in favor of financing agencies.[14] In view of the above conflicting policy considerations, the problem should be left to the legislatures for comprehensive and definitive treatment.[15] Meanwhile, the courts should not go beyond the provisions of the statutes in an attempt to protect the purchaser. He has a remedy against the dealer to the same extent as the cash buyer. The negotiability of his promissory note should not be sacrificed by subjecting the purchaser to the personal defenses between the original parties unless actual notice of the infirmity in the instrument clearly is present.[16]

William G. Cloon, Jr., S.Ed.

[12] As to the existence of actual notice in the principal case, see note 1 supra.

[13] Note the strong language used in favor of protecting the purchaser in Buffalo Industrial Bank v. De Marzio, 162 Misc. 742, 296 N.Y.S. 783 (1937), revd. on other grounds, 6 N.Y.S. (2d) 568 (1937).

[14] On the importance of the finance company to the economic development of the nation, see Grimes, "Distribution and the Finance Company," 18 HARV. BUS. REV. 199 (1940).

[15] Some statutes limit the rights of the finance companies. See Ill. Rev. Stat. (1953) c. 95, §26; Md. Code Ann. (Flack, 1951) art. 83, §134; Pa. Stat. Ann. (Purdon, Supp. 1954) tit. 69, §615G. Also note the definition of "seller" in Uniform Conditional Sales Act §1. For the treatment under the Uniform Commercial Code, see 57 YALE L.J. 1414 (1948).

[16] The purchaser should not be required to search for additional facts which reasonable inquiry might disclose. Commercial paper, like money, must remain liquid to facilitate its exchange. See BRITTON, BILLS AND NOTES §112 (1943).