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## BILLS AND NOTES-REACQUISITION AND REISSUE BY A PRIOR PARTY-LIABILITY OF INTERMEDIATE INDORSER TO SUBSEQUENT HOLDER IN DUE COURSE

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**BILLS AND NOTES—REACQUISITION AND REISSUE BY A PRIOR PARTY—LIABILITY OF INTERMEDIATE INDORSER TO SUBSEQUENT HOLDER IN DUE COURSE**—The payee of a negotiable note indorsed to *X*, who later indorsed back to the payee, who before maturity indorsed to a holder in due course. All indorsements were special. On default, the holder brought suit to enforce the secondary liability of the payee and *X*, the intermediate indorser. Both defendants appealed from a judgment for the holder. *Held*, reversed as to *X*. The reacquisition of a note by a payee terminates the contractual liability of an intermediate indorser as to a holder subsequent to the payee. *Denniston's Admr. v. Jackson*, 304 Ky. 261, 200 S.W. (2d) 477 (1947).

The status of a payee<sup>1</sup> who reacquires a negotiable instrument, and of holders who take subsequent to such reacquisition, may be analyzed in either of two ways. The reacquisition may be treated as a reinstatement of the party in his former position, all intermediate indorsements being nullified, in legal contemplation. The payee is said to stand in his "old shoes," and this theory has

<sup>1</sup>While the term "payee" is used in this note to indicate the reacquiring party, it should be observed that the status of a reacquiring subsequent holder is for most purposes indistinguishable. *Contra*, by construction of N.I.L., section 58 (cited in footnote 3, *infra*): *Horan v. Mason*, 141 App. Div. 89, 125 N.Y.S. 668 (1910). See Brannan, "Some Necessary Amendments of the Negotiable Instruments Law," 26 HARV. L. REV. 493 (1913). For a discussion of the status of an instrument reacquired by the party primarily liable, see L.R.A. 1918 E, 170.

sometimes been so named. On the other hand, the payee may be treated as a purchaser acquiring a new title which is traced through intermediate indorsements as well as his own prior indorsement.<sup>2</sup> The Uniform Negotiable Instruments Law cannot be said to have adopted either theory in toto. In view of the dissimilarity of the problems raised in this situation, consistency of approach should be regarded as a matter of slight importance. In general, there are two classes of cases in which the question is raised. One involves the right of a reacquiring party or subsequent holder to enforce the obligation of the party primarily liable on the instrument, free of defenses of such party because of the bona fides of an intermediate holder. This problem is covered, inconsistently it may be, by section 58<sup>3</sup> and section 121,<sup>4</sup> although the sections may be harmonized.<sup>5</sup> The policy of the law is to grant to a holder in due course as broad a market as possible, despite the later discovery of defect in the title, without allowing recovery to a fraudulent party. Since section 58 does not protect the holder's market in respect to a purchaser, himself a party to any fraud or illegality, it may well be that a subsequent holder from such purchaser will not be protected if he is not himself a holder in due course.<sup>6</sup> A second class of cases, to which the principal case belongs, raises the question of the liability of the intermediate indorser after reacquisition of the instrument by a prior party.<sup>7</sup> As to such prior party himself, section 50 clearly applies the "old shoes" theory. From the language of the section as well as from the history of the rule at common law,<sup>8</sup> the rule is aimed at preventing circuity of action and does not express any

<sup>2</sup> An extended treatment of the two theories, beyond the scope of the present note, will be found in Chafee, "The Reacquisition of Negotiable Instruments by a Prior Party," 21 *COL. L. REV.* 538 (1921).

<sup>3</sup> "In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. But a holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect of all parties prior to the latter."

<sup>4</sup> "Where the instrument is paid by a party secondarily liable thereon, it is not discharged; but the party so paying it is remitted to his former rights as regards all prior parties. . . ."

<sup>5</sup> Use of the word "paid" strongly suggests that section 121 applies only in cases of negotiation after maturity, by virtue of section 88, defining payment in due course. But see Chafee, "The Reacquisition of Negotiable Instruments by a Prior Party," 21 *COL. L. REV.* 538 (1921).

<sup>6</sup> To this effect see *Comstock v. Buckley*, 141 Wis. 228, 124 N.W. 414 (1910); *Booher v. Allen*, 153 Mo. 613, 55 S.W. 238 (1900); *Weil v. Carswell*, 119 Ga. 873, 47 S.E. 217 (1904). To the effect that the same theory was applied to chattels, see *The W. B. Cole*, (C.C.A. 6th, 1893) 59 F. 182. See also BEUTEL, *BRANNAN'S NEGOTIABLE INSTRUMENTS LAW ANNOTATED* 713 et seq. (1938).

<sup>7</sup> The problem of liability on indorsement may be considered as separable from the problem of taking free of defenses, except perhaps where a maker's defense is added to the facts of the instant case. If the plaintiff here had been granted recovery against the intermediate indorser, the latter in turn could recover from the maker free of defenses, and thus the original plaintiff could in effect reach the maker in two steps and accomplish what might be impossible in one. (See note 6, supra.)

<sup>8</sup> *Bishop v. Hayward*, 4 T.R. 470, 100 Eng. Rep. 1124 (1791); *Britten v. Webb*, 2 B. & C. 483, 107 Eng. Rep. 463 (1824); *Sawyer v. Wiswell*, 9 Allen (91 Mass.) 39

presumption that the intermediate parties took only for security and indorsed in return without intending to incur liability. It should follow, therefore, that a holder in due course, who was not a prior party himself, but who took from a reacquiring party, is not within the rationale of section 50 but is rather entitled by section 57 to take free of "defenses available to prior parties among themselves."<sup>9</sup> Such holder is of course charged by the order of the indorsements with knowledge that the reacquiring party may not enforce the instrument against intermediate indorsers, but to argue that he is thereby charged with knowledge that he may not himself so enforce the instrument is to assume the issue in controversy. Nevertheless, the authorities are in conflict, both at common law<sup>10</sup> and under the N.I.L.<sup>11</sup> The court in the principal case did not consider the effect of section 48, which grants the holder an election to strike out indorsements unnecessary to his chain of title. This suggests that the payee takes as a purchaser from an intermediate indorser unless the payee elects reinstatement to his former position. It will be seen that the decision in the instant case removes any possibility of election in the case of the reacquiring party. It is submitted that there is no valid reason for terminating the contractual obligation voluntarily<sup>12</sup> assumed by an indorser, where nothing more appears than that the instrument in subsequent negotiation passed through the hands of a prior holder.

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(1864), where the "intermediate indorser" had in fact signed for the accommodation of the payee, action by the latter against the former was allowed. See *Herrick v. Carman*, 12 Johns. (N.Y.) 159 (1815) and *Howe Mach. Co. v. Hadden*, (C.C. Ind. 1878) 8 Biss. 208, Fed. Cas. No. 6785.

<sup>9</sup> Section 66 would lead to the same result in the case of a general indorsement.

<sup>10</sup> Holding the indorser: *West Boston Savings Bank v. Thompson*, 124 Mass. 506 (1878). Releasing the indorser: *Howe Mach. Co. v. Hadden*, (C.C. Ind. 1878) 8 Biss. 208, Fed. Cas. No. 6785; *Adrian v. McCaskill*, 103 N.C. 182, 9 S.E. 284 (1889).

<sup>11</sup> Holding the indorser: *Persky v. Bank of America*, 235 App. Div. 146, 256 N.Y.S. 572 (1932), reversed on other grounds, 261 N.Y. 212, 185 N.E. 77 (1933); *State Finance Corp. v. Pistorino*, 245 Mass. 402, 139 N.E. 653 (1923). Releasing the indorser: *Ray v. Livingston*, 204 N.C. 1, 167 S.E. 496 (1933), noted in 17 MINN. L. REV. 808 (1933), criticized by Beutel in BRANNAN'S NEGOTIABLE INSTRUMENTS LAW ANNOTATED 531-2 (1938).

<sup>12</sup> The obligation is voluntarily assumed in the sense that the law recognizes qualified indorsements.