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BILLS AND NOTES--HOLDER IN DUE COURSE-PURCHASING INSTALLMENT AFTER MATURITY

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RECENT DECISIONS

BILLS AND NOTES—HOLDER IN DUE COURSE—PURCHASING INSTALLMENT AFTER MATURITY—Three installment notes were pledged to the plaintiffs by the payee as security. At the time plaintiffs took the notes, the first installment of each was overdue and unpaid. In an action by plaintiffs against the makers, the latter pleaded in defense failure of consideration and fraud on the part of the payee. *Held*, plaintiffs were not holders in due course and consequently took the notes subject to the defense of the makers. *Bliss v. California Co-op. Producers*, (Cal. 1946) 172 P. (2d) 62.

Purchasing an instrument after maturity was originally treated as a matter of notice affecting the good faith of the purchaser.¹ Although the common law conception of what constituted bad faith underwent some historical changes,² the doctrine that a purchaser of overdue paper cannot under any circumstances be a holder in due course became the rule under section 52(2) of the N.I.L.,³ thus precluding such purchaser from claiming the rights of a holder in due course on the ground of his good faith. Purchase of an installment note after an installment is overdue and unpaid presents the question in a slightly different manner, for here the ultimate maturity of the note has not yet arrived. Should taking of such an instrument with knowledge of the default be analogous to taking an instrument after its ultimate maturity? In both cases the question as to why the instrument was in default would arise in the taker's mind. This should undoubtedly suggest a possible defense on the part of the maker. While there may be more grounds for suspicion where the entire instrument is overdue, this is at most a matter of degree, so there seems to be no sound basis for a distinction in this regard. The common law cases so held,⁴ and the question

¹ "But where a negotiable note is found in circulation after it is due, it carries suspicion on the face of it. The question instantly arises, Why is it in circulation,—why is it not paid? here is something wrong. Therefore, although it does not give the indorser notice of any specific matter of defence, such as set-off, payment, or fraudulent acquisition, yet it puts him on inquiry; he takes only such title as the indorser himself has, and subject to any defense which would be made, if the suit were brought by the indorser." *Fisher v. Leland*, 58 Mass. 456 at 458 et seq. (1849); *Brown v. Davies*, 3 T.R. 80, 100 Eng. Rep. 466 (1789); 8 Am. Jur., § 431, and cases cited.

² BRITTON, *BILLS AND NOTES* 407 et seq. (1943), and cases cited; Rightmire, "The Doctrine of Bad Faith in the Law of Negotiable Instruments," 18 MICH. L. REV. 355 (1920).

³ 52. "A holder in due course is a holder who has taken the instrument under the following conditions: . . . 2. That he became the holder of it before it was overdue, and without notice that it had been previously dishonored, if such was the fact. . . ."

⁴ ". . . and as to the amount of that installment, it is not to be doubted that the defendant may make the same defense against the plaintiff, which he might have made against the payee. And we are of opinion that he might make the same defense to the whole note . . . the plaintiff took it with notice on its face that, as to the first installment, the defendant might have a justifiable cause for withholding payment, whatever that cause might be; whether a cause which affected that installment only—as a release thereof by the payee, or a legal set-off against him to the amount thereof—or a

arises whether the N.I.L. supports such a view. Section 52(2) indicates that the purchaser must have become "the holder of it before it was overdue." Is an installment note overdue when one of its installments is in default? The common law decisions answered this in the affirmative where the question was whether a subsequent purchaser was holder in due course.⁵ With this in mind it seems reasonable to say that such an instrument is overdue within the meaning of section 52(2).⁶ If this be conceded, the further question arises whether a good faith purchaser who takes such an instrument without knowledge of the default should be protected. Although it is somewhat common practice to record on the note itself receipt of payments as made, this is not required by the N.I.L., and many instances arise where such notations are not made,⁷ the maker merely treating his cancelled checks as receipts.⁸ It may seem difficult to protect such a purchaser if it be said that such an instrument is covered by the arbitrary rule of section 52(2); yet the same problem is presented with acceleration paper where a previous holder has exercised his option to accelerate. In the latter case, although technically the instrument is overdue, the weight of authority is to the effect that the purchaser of such an instrument after acceleration can rely on the ultimate due date if he has no knowledge of the acceleration.⁹ This holding appears reasonable.¹⁰ By analogy it would seem that a like distinction might be drawn in the purchase of installment notes not containing an acceleration clause.¹¹

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cause which, between him and the payee, vitiated the whole note, as want or failure of consideration, fraud or duress." *Vinton v. King*, 86 Mass. 562 at 565 (1862); *Field v. Tibbetts*, 57 Me. 358 (1869); *McCorkle v. Miller*, 64 Mo. App. 153 (1895); *Hall v. E. W. Wells & Son*, 24 Cal. App. 238, 141 P. 53 (1914); *General Motors Acceptance Corp. v. Talbott*, 39 Idaho 707, 230 P. 30 (1924).

⁵ *Supra*, note 4.

⁶ In accord with this conclusion: *Hibbard v. Collins*, 127 Me. 383, 143 A. 600 (1928); *United States v. Capen*, (D.C. Vt. 1944) 55 F. Supp. 81.

⁷ "The absence of any indorsement on the instrument that installments have been paid is not per se notice and does not subject a purchaser to equities." Chafee, "Acceleration Provisions in Time Paper," 32 HARV. L. REV. 747 at 769 et seq. (1919).

⁸ A common example of such an instance is where the holder keeps the note in a safety deposit box and payments are made by check.

⁹ BRITTON, *BILLS AND NOTES* 504 et seq. (1943), and cases cited; 10 C.J.S., § 251a, p. 748 (1938), and cases cited.

¹⁰ Chafee, "Acceleration Provisions in Time Paper," 32 HARV. L. REV. 747 at 765 (1919).

¹¹ Professor Chafee states very definitely that such a distinction should be drawn. "If a note is payable in several installments without any acceleration provision, and one installment is known to be overdue, then a purchaser, though ignorant of equitable defenses, will be barred by such a defense from recovering subsequent installments, because he had ground to suspect some valid reason for the default. If due notice of the dishonor was not given to indorsers, this is an equitable defense which would prevent the purchaser who knew of the dishonor from charging them at all. Therefore, an installment note with an acceleration provision is in these respects overdue on default, even though the option has not been exercised, and a holder with notice of the default is affected. The same result would follow if the option had been exercised, and a subsequent purchaser knew of the default, but not of the holder's election. In