Volume 7 | Issue 4

Article 12

1956

Accelerating the Maturity of Negotiable Instruments

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Accelerating the Maturity of Negotiable Instruments

Negotiable instruments are substitutes for money. Debtors who cannot presently pay debts in cash give notes to their creditors to mature at a subsequent date. These notes are taken by the businessman, discounted at a bank and in that manner converted into cash. Like money, the value of a negotiable instrument lies in the fact that a holder, on sight, can determine its value without investigating outside facts or third party claims. To insure free circulation the law merchant developed certain formal requisites to distinguish negotiable notes from other written instruments. These requisites were outgrowths of the business needs of the day. They are not requisites that may be formulated by mathematical computation or legal reasoning but are customs that have grown out of generations of business experience. Business custom should be the decisive factor rather than a rule of law.

> An uncertainty which does not impair the function of negotiable instruments *in the judgment of business men* ought not to be regarded by the courts. The fine phrase of Chief Justice Gibson in the case of Overton v. Tyler, 3 Pa. 346, that a negotiable instrument "is a courier without luggage," has been made to do much service in the discussion of the subject. The real question, however, is who shall determine what constitutes "luggage" — the business world, or the judge in his library. (Emphasis added.)[1]

Soon these formalities became part of the common law, but because of varying business customs throughout the country the decisions were not harmonious. In an attempt to attain uniformity the Uniform Negotiable Instruments Act was drafted and adopted by all forty-eight states.[2]

However, there is still a great deal of confusion and uncertainty in the cases dealing with the NIL. One of the most disturbing areas is that which deals with the certainty of time of maturity. Section 1 (3) of the NIL provides that an instrument to be negotiable "must be payable on demand or at a fixed or determinable future time." An instrument payable at a "fixed future time" is defined in section 4 (2) as one which is "payable on or before a fixed or determinable future time specified therein." Not mathematical but practical certainty is required by this rule.[3] A maker, primary obligor or acceptor must know from looking at the instrument when he may pay or when the holder may compel

[1] 32 HARV. L. REV. 751 (1919)

[2] Also adopted in Alaska, District of Columbia, and Hawaii.

[3] State Bank v. Bilstad, 162 Iowa 433, 136 N.W 204 (1912), *modified on rehearing*, 144 N.W 363 (1913)

payment. Secondary parties must know when a default may occur and when their obligation arises. Holders should know when they may demand their money and when they must give notice to secondary parties on a default. The value of an instrument depends, in fact, on the certainty of its maturity. For these reasons certainty of the time of maturity is imperative.

Most of the confusion in this area centers around acceleration clauses. A note containing such a clause is one which is payable at a fixed date of maturity with a clause providing for the acceleration of payment upon the happening of certain specified contingencies.

There are three classes of accelerating clauses: (1) where the happening of the event rests with maker; the holder having an election to declare the whole sum due; (2) where the happening of the accelerating event is dependent on an extrinsic event; (3) where the acceleration is within the control of the holder. These clauses and the reasoning upon which courts have based their decisions warrant discussion. This note will attempt to enumerate the various reasons invoked by the courts and evaluate the conflicting decisions.

MAKER ACCELERATION

The confusion is at a minimum as to accelerating clauses of the first class. Notes providing for acceleration upon default in payment of any installment,[4] default in payment of interest,[5] failure to comply with terms of mortgage,[6] or default in the payment of one of a series of notes[7] are

[4] McCormick v. Daggett, 162 Ark. 16, 257 S.W 358 (1924); Star Brewing Co. v. Higgins, 248 Mass 480, 143 N.E. 332 (1924); National City Bank v. Erskine & Sons, 158 Ohio St. 450, 110 N.E.2d 598 (1953); DeWolf v. Church, 180 Okla. 66, 67 P.2d 930 (1937); Illinois Bankers Life Assur. Co. v. Day, 178 Okla. 284, 62 P.2d 970 (1936); Jones v. Morris Plan Bank, 168 Va. 284, 191 S.E. 608 (1937); Abingdon Bank & Trust Co. v. Shipplett-Moloney Co., 316 Ill. App. 79, 43 N.E.2d 857 (1942); Drey State Motor Co. v. Nevling, 106 Pa. Super. 42, 161 Atl. 880 (1932); Barton v. Kansas City Life Ins. Co., 98 S.W.2d 836 (Tex. Civ. App. 1937)

[5] First Nat'l Bank v. DeJernett, 229 Ala. 564, 159 So. 73 (1935); Arnett v. Clack, 22 Ariz. 409, 198 Pac. 127 (1896); Utah State Nat'l Bank v. Smith, 180 Cal. 1, 179 Pac. 160 (1919); Webster v. 759 Riverside Ave., 113 Fla. 8, 151 So. 276 (1933); Hutson v. Rankin, 36 Idaho 169, 213 Pac. 345 (1922); Hubbard v. Robert B. Wallace Co., 201 Iowa 1143, 208 N.W 730 (1926); Commercial Savings Bank v. Schaffer, 190 Iowa 1088, 181 N.W 492 (1921); Clark v. Skeen, 61 Kan. 526, 60 Pac. 327 (1900); Moore v. Interstate Trust Co., 172 Okla. 471, 45 P.2d 485 (1935); Koppler v. Bugge, 168 Wash. 182, 11 P.2d 236 (1932); Trigg v. Arnott, 22 Cal. App.2d 455, 71 P.2d 330 (1937).

[6] McCormick v. Daggett, 162 Ark. 16, 257 S.W 358 (1924); Davis v. Union Planters Nat'l Bank, 171 Tenn. 383, 103 S.W.2d 579 (1937).

[7] Farmers' Bank & Trust Co. v. Dent, 206 Ky. 405, 267 S.W 202 (1924); Finley v. Smith, 165 Ky. 445, 177 S.W 262 (1915); Walter v. Kilpatrick, 191 N.C. 458, 132 S.E. 148 (1926); Havens v. Foskett, 81 Cal. App. 653, 254 Pac. 642 (1927);

generally held to be negotiable. The accelerating event in this instance is dependent upon an act or an omission to act on the part of the maker. The majority of courts reason that the time at which such a note will ultimately become due is certain on the face of the note, and thus, as required by sections 1 (3) and 4 (2), it is payable at a fixed or determinable future time. The fact that maturity is liable to be accelerated through some act or omission of the maker does not alter the ultimate maturity date expressed on the note.

> Of course, the default of the maker in the payment of interest or the performance of some other agreement or covenant may accelerate the "due date," and in this event the instrument will still be negotiable providing it is payable upon a fixed or determinable future date, for under those circumstances it is certain that the time will arrive when the note would be payable and the circumstances that it might become payable before that time upon the default of the maker in certain respects at the option of the payee or holder would not affect its negotiability.[8]

EXTRINSIC ACCELERATION

Although there is some authority to the contrary,[9] notes providing for acceleration if the maker should suffer a fire loss,[10] if a certain crop is below eight bushels per acre,[11] if money is made out of a certain sale,[12] or if the maker should fail in business,[13] are held negotiable. Again most courts say that, in accordance with sections 1 (3) and 4 (2), there is a specified date of maturity which is not rendered uncertain by a provision providing for payment at an earlier date. Whether or not the accelerating event takes place the note is bound to become due at the specified date therein.[14] A few courts uphold the negotiability of such a note merely on the ground that the clause is not similar to those contained in the third class — at the "whim and caprice" of the holder.[15]

Taylor v. Goodrich Tire & Rubber Co., 20 Tenn. App. 352, 98 S.W.2d 1094 (1937).

[8] First Nat'l Bank v. McCartan, 207 Iowa 1036, 220 N.W 366 (1928).

[9] Rohr v. Jeffery, 128 Kan. 541, 278 Pac. 725 (1929); Brooks v. Hargreaves, 21 Mich. 254 (1870); Great Falls Nat'l Bank v. Young, 67 Mont. 328, 215 Pac. 651 (1923); Devine v. Price, 152 N.Y. Supp. 321 (Sup. Ct., 1st Dep't 1915).

[10] People's Finance & Thrift Co. v. Shaw-Leahy Co., 295 Pac. 1072 (Cal. 1931), *aff'd,* 214 Cal. 108, 3 P.2d 1012 (1931); McCormick v. Gem State Oil and Products Co., 38 Idaho 470, 222 Pac. 286 (1923).

[11] State Bank v. Bilstad, 162 Iowa 433, 136 N.W 204 (1912), *modified on rehearing,* 144 N.W 363 (1913).

[12] Cisne v. Chidester, 85 Ill. 523 (1877); Charlton v. Reed, 61 Iowa 166, 16 N.W 64 (1883); Ernst v. Steckman, 74 Pa. 13 (1873).

[13] Bonart v. Rabito, 141 La. 970, 76 So. 166 (1917).

[14] State Bank v. Bilstad, 162 Iowa 433, 136 N.W 204 (1912), *modified on rehearing,* 144 N.W 363 (1913).

[15] McCormick v. Gem. State Oil and Products Co., 38 Idaho 470, 222 Pac. 286

HOLDER ACCELERATION

Confusion is at a maximum when the note provides that the holder may accelerate maturity whenever he deems himself insecure. Courts typically hold this type of note non-negotiable. Many cases, without explanation, flatly say that the time of payment is uncertain,[16] while others merely cite precedent holding such notes non-negotiable.[17] On the other hand, some courts attempt to differentiate this type of acceleration from that dependent upon an act or omission of the maker or upon an extrinsic event.[18]

Section 1 (3) states that an instrument to be negotiable must be payable on demand or at a fixed or determinable future time. Acceleration clauses are not mentioned; one type is given no preference over another. Since no differentiation is made in the wording of the statute it would seem that as long as a note is payable at a fixed or determinable future time it may provide for any type of acceleration as long as it does not affect the ultimate maturity date.[19] If one type of accelerating clause comes within section 1 (3) all accelerating clauses should. But this is not the view taken by the vast majority of courts as to such notes. They are held to be at the "whim and caprice" of the holder and consequently non-negotiable because the time of maturity is uncertain.

> An obligation of this character is too uncertain to serve the purpose of commercial paper. By the weight of authority it is held that a condition of this sort introduces an element of uncertainty as to the time of payment, and the amount to be paid, and renders the note non-negotiable.[20]

The reason and logic behind this view is difficult to understand. On the one hand most courts say that as long as there is a definite date of

(1923); People's Finance & Thrift Co. v. Shaw-Leahy Co., 295 Pac. 1073 (Cal. 1931), *aff'd,* 214 Cal. 108, 3 P.2d 1012 (1931).

[16] Kimpton v. Studebaker Bros. Co., 14 Idaho 552, 94 Pac. 1039 (1908); First Nat'l Bank v. Carter, 144 Iowa 715, 123 N.W 237 (1909); Oklahoma State Bank v. Gandfield First Nat'l Bank, 108 Okla. 272, 236 Pac. 581 (1925); Continental Nat'l Bank v. Wells, 73 Wis. 332, 41 N.W 409 (1889).

[17] Murrell v. Exchange Bank, 168 Ark. 645, 271 S.W 21 (1925); Moyer v. Hyde, 35 Idaho 161, 204 Pac. 1068 (1922); Holliday State Bank v. Hoffman, 85 Kan. 71, 116 Pac. 239 (1911); Harrison v. Fugatt, 179 Okla. 367, 65 P.2d 1200 (1937); Western Farquhar Machinery Co. v. Burnett, 82 Ore. 174, 161 Pac. 384 (1916); Reynolds v. Vent, 73 Ore. 528, 144 Pac. 526 (1914); Puget Sound State Bank v. Washington Paving Co., 94 Wash. 504, 162 Pac. 870 (1917); People's Bank v. Porter, 58 Cal. App. 41, 208 Pac. 200 (1922); Old Colony Trust Co. v. Stumpel, 126 Misc. 375, 213 N.Y. Supp. 536 (Sup. Ct. 1926).

[18] First Nat'l Bank v. McCartan, 206 Iowa 1036, 220 N.W 364 (1928); First State Bank v. Barton, 129 Okla. 67, 263 Pac. 142 (1928); Guio v. Lutes, 97 Ind. App. 157, 184 N.E. 416 (1933).

[19] 77 U. PA. L. REV. 313 (1929).

[20] Murrell v. Exchange Bank, 168 Ark. 645, 271 S.W 21 (1925).

maturity expressed on the note there may be accelerating provisions dependent on an act or omission of the maker or on the occurrence of an outside event. But where the note contains a specified date of maturity and permits acceleration at the option of the holder the time of maturity is said to be uncertain. Uncertainty, the courts say, is due to the fact that the maturity is within the "whim and caprice" of the holder. "Whim and caprice" seems to be the magical phrase, but what does it mean? Does the fact that the holder may demand payment at his own discretion render the date of maturity any more uncertain than it is where it is dependent on an act or omission of the maker or where an outside event controls the time of payment? Logic demands that as to certainty the clauses should be treated alike, but the majority of decisions rule otherwise.

> the maker is not in default in the first instance and only becomes in that predicament through an election of the holder over which no one has any control except the elector himself. Presented here is a different situation than that which arises causing acceleration because the maker fails to perform some duty and for that reason is in default. Therefore, the maturity date is uncertain and non-negotiability results.[21]

Section 4 (2) of the NIL states: "an instrument is payable at a determinable future time, within the meaning of this act, which is expressed to be payable on or before a fixed or determinable future time specified therein." It has been argued that this section requires the note to contain the statutory language "on or before." If it does not, the note is non-negotiable.[22] The harshness of such a rule is evident. Hardly any note containing an acceleration clause of any type would be valid if such a rule were adhered to. A more reasonable interpretation of this section would be that it requires the note to be, in fact, payable "on or before" the stated maturity date.[23]

A cogent argument against the majority view that a holder's option invalidates negotiability is that such a clause actually increases its marketability. To circulate freely a note must appeal to a prospective holder. Holders should be able to look at the note and determine its value in terms of money, the time for demanding payment, and the time for giving notice to parties secondarily liable. If the note is payable at the holder's discretion he will have little trouble in answering these questions. It is difficult to understand why a note that presents the least difficulty to the holder is uniformly held non-negotiable.

One reason for the obstinacy of the majority view seems to be based on policy considerations. The courts which do attempt to fortify their

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[21] First Nat'l Bank v. McCartan, 206 Iowa 1036, 220 N.W 364 (1928)

[22] Guio v. Lutes, 97 Ind. App. 157, 184 N.E. 416 (1933)

[23] Utah State Nat'l Bank v. Smith, 180 Cal. 1, 179 Pac. 160 (1919)

decisions with reasons talk of protecting the maker from a supposedly unmerciful holder.[24] These courts are very much concerned that the maker has absolutely no control over the acceleration, and consequently they lighten the burden by declaring such notes non-negotiable. Since both parties have objectively manifested an intent to make the note negotiable a remedy that follows this intent is more desirable. Perhaps a more suitable remedy would be to strike such a clause from the face of the note as a matter of public policy. This would rid the note of the "offensive" holder-acceleration and still leave the requisites for negotiability intact. Certainly policy considerations must be thoughtfully weighed in any decision. But we must not lose sight of other factors. Of these other factors one of the most important is the underlying basis of the NIL—free circulation. Too much concern for the debtor's position tends to suppress negotiability and defeat the principles of negotiable instruments law.

Another frequently advanced argument for non-negotiability is that subsequent holders might not be able to ascertain whether such a note has actually been matured before the date of maturity appearing on its face, and therefore a bona fide purchaser may be declared not to be a holder in due course. However, such an argument is answered by a reference to the NIL. Section 52 (2) says: a "holder in due course is a holder who has taken the instrument under the following circumstances; 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." A note with a fixed date of maturity is payable on that specified date.[25] As long as the transferee takes the note before the date appearing on its face and without knowledge that the note has been accelerated, the fact that the accelerating event has taken place is of no importance as to the transferee's rights as a holder in due course.[26] In the words of the Supreme Court of Colorado:

> No transaction between the acceptor and holder of a negotiable instrument can advance its maturity as against a subsequent holder in due course, even though it was negotiated after such transaction. If it could, the safety of negotiable paper would be destroyed, and the law merchant nullified.[27]

Thus if a subsequent transferee takes before the ultimate fixed date, in good faith, and without notice of any defect in the instrument, he will be accorded the rights of a holder in due course.

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[24] See notes 17 and 18 *supra*.

[25] Calhoun v. Ainsworth, 118 Ark. 316, 176 S.W 316 (1915).

[26] *Cf.* Citizens Nat'l Bank v. First Nat'l Bank, 66 Colo. 426, 182 Pac. 12 (1919); Dunn v. O'Keeffe, 5 M. & S. 282 (Court of King's Bench 1816).

[27] Citizens Nat'l Bank v. First Nat'l Bank, 66 Colo. 426, 182 Pac. 12 (1919).

But what protection is afforded the maker? Is it not possible that he may be made to pay twice through no fault of his own? It has been said that if a holder can declare the whole sum due before the ultimate maturity date, it might, under certain circumstances, creep back into circulation. Then, if transferred to a holder in due course, the maker could be forced to pay a second time.[28] This is a problem that is pertinent not only to notes accelerable by the holder but to all types of acceleration notes. If such a thing does happen it cannot be said that it was without the maker's fault. The burden is upon the maker to make certain that the note is surrendered upon payment.

CONCLUSION

To be negotiable, an instrument must be payable on demand or at a fixed or determinable future time. Maturity, however, may be made subject to certain accelerating contingencies which do not destroy the certainty of the time for payment. If the acceleration depends upon an act or omission of the maker or upon the occurrence of an extrinsic event, the vast majority of courts hold such notes negotiable. Such instruments are payable at a fixed or determinable future time as required by section 1 (3) of the NIL. On the other hand, if the note is accelerable at the option of the holder, the time of maturity is within the holder's "whim and caprice," and consequently is uncertain and the note non-negotiable. These rules are succinctly stated in an early opinion of the Supreme Court of Pennsylvania:

> The principle to be deduced from the authorities is this: To constitute a negotiable promissory note the time or the event for its ultimate payment must be fixed and certain; yet it may be made subject to contingencies, upon the happening of which, prior to the time of its absolute payment, it shall become due. The contingency depends upon some act done or omitted to be done by the maker, or upon the occurrence of some event indicated in the note; and not upon any act of the payee or holder, whereby the note may become due at an earlier day.[29]

It is submitted, however, that as to notes accelerable at the option of the holder the more logical and reasonable view is expressed by Professor Brannan:

> that these cases holding an instrument payable at a fixed time but accelerable at the option of the payee or holder non-negotiable are directly contrary to the plain meaning of this section. Such instruments are certainly payable "on or before a fixed time specified therein," and to hold them non-negotiable is certainly a spurious construction of the act. Under a proper interpretation, these cases should be overruled.[30]

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[28] First State Bank v. Barton, 129 Okla. 67, 263 Pac. 142 (1928)

[29] Ernst v. Steckman, 74 Pa. 13 (1873).

[30] BRANNAN, NEGOTIABLE INSTRUMENTS 169-70 (6th ed. 1938)