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Negotiable Instruments

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NEGOTIABLE INSTRUMENTS

Amount of Recovery: Note Purchased at Discount

In *National Equity Discount & Loan Co. v. Jackson*,[1] the plaintiff bought a note in the amount of $348.45 for $150. Although the trial court found that the maker had no defense to the note, he nevertheless gave judgment for only $150, plus interest. This startling decision was reversed by the court of appeals, which held, correctly, that in the absence of any defense, the holder is entitled to collect the full amount due on the instrument. The court also indicated correctly that even if there are defenses, the holder in due course is entitled to collect the full amount.[2] No reference was made to the Negotiable Instruments Law.

Holder In Due Course: Taking Incomplete Instrument

Ohio Revised Code section 1301.54[3] defines a holder in due course as a holder who has taken the instrument under certain conditions, the first of which is that it be complete on its face. Correctly interpreting the statute (if, indeed, there is room for interpretation in the situation presented), the court of appeals in *Salter v. Mutual Finance Co.*[4] held that a finance company which purchaseed an incomplete instrument was not a holder in due course even though in fact the company took in good faith.[5]

Holder In Due Course: Bad Faith: Constructive Notice

Ohio Revised Code section 1301.58,[6] dealing with the question of what constitutes notice of an infirmity in the instrument or defect in the title of the person negotiating it, provides that to constitute the above, the person to whom the instrument is negotiated "must have had actual

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1. 105 Ohio App. 278, 151 N.E.2d 914 (1957).

2. There is an exception in the case of a note taken as security, but the exception is not involved in the instant case.

3. NEGOTIABLE INSTRUMENTS LAW § 52.

4. 106 Ohio App. 20, 153 N.E.2d 216 (1957).

5. The opposite result was reached in First Discount Corp. v. Hatcher Auto Sales, Inc., 156 Ohio St. 191, 102 N.E.2d 4 (1951), abstracted in the 1952 Survey, 4 WEST. RES. L. REV. 246 (1953). The decision is criticized in 21 U. CINC. L. REV. 207 (1952) and is also discussed in 13 OHIO ST. L. J. 294 (1952). As pointed out in the concurring opinion of Judge Taft, it was unnecessary to decide the issue of holder in due course, as the suit was against the indorser and based on his warranty that all prior parties had capacity to contract.

6. NEGOTIABLE INSTRUMENTS LAW § 56.

knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith."

The last phrase is the troublesome one. In general, however, the doctrine of constructive notice does not apply in this area.[7] Yet in *Botzum Bros. v. Brown Lumber Co.*,[8] the court made use of the doctrine in deciding that the planitiff[9] was not a holder in due course. The case arose under an FHA (Federal Housing Administration) loan, in which Bremson, the payee of the notes under the trade name Nu Homes, was doing construction work for the defendants. The plaintiff, a savings and loan association, was the financial institution advancing the money needed to pay Bremson.

The plaintiff claimed to be a holder in due course of the notes. Under FHA regulations, known to the plaintiff, the latter was not authorized to disburse the proceeds of a loan until it had obtained completion certificates, one of which was to be signed by the borrower. Bremson forged the names of the two borrowers (the makers of the notes), and on the strength of the certificates, not knowing of the forgery, the plaintiff disbursed the money to Bremson. The court held that under Ohio Revised Code section 1301.58, referred to above, the plaintiff had knowledge of such facts that its action in taking the instruments amounted to bad faith. Consequently, the plaintiff was not a holder in due course and was therefore subject to the defense which the makers had against the payee. The court stated that the FHA regulation requiring a completion certificate signed by the borrower was adopted for the protection of borrowers and was a limitation on the authority of the plaintiff to make a disbursement on the loan. When plaintiff paid out on forged certificates, reasoned the court, it was the same as though there were no certificates at all.

The opinion is not entirely clear to me because, after the above unqualified statements, the court indicated that the duty of plaintiff was to take reasonable precautions to ascertain that the borrowers' completion certificates were genuine, and that the conduct of plaintiff, in view of the knowledge which its officer had, amounted to a taking in bad faith. But the only pertinent knowledge which the officer had was that payments could not be made except on the strength of the certificates, and the only pertinent "conduct" which the court could have intended to denounce, was the failure to inquire of the borrowers whether the work had been

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7. BRITTON, BILLS AND NOTES § 112 (1943).

8. 104 Ohio App. 507, 150 N.E.2d 485 (1957).

9. For the sake of simplicity I have designated this party as plaintiff, although technically he was a cross-petitioner.

satisfactorily completed or whether they had in fact signed the completion certificates.[10] Thus, in effect, the court appears to be holding that plaintiff was on constructive notice of the fact that the certificates were forged.

Want of Consideration: Burden of Proof

Ohio Revised Code section 1301.30[11] makes absence of consideration a matter of defense against any person not a holder in due course. Although the section says nothing about burden of proof, the weight of authority is that the section places the burden of proof on the defendant.[12]

In connection with a promissory note issued before the effective date of the Negotiable Instruments Law in Ohio, the Supreme Court of Ohio held that the burden of proof was on the plaintiff (usually the payee) to establish consideration where it was denied.[13] So far as I know, there has been no Supreme Court decision under the Negotiable Instruments Law.

In *Lucas v. Rosenacker,*[14] the court said that the burden of proving the defense of want of consideration is placed upon the defendant by Ohio Revised Code section 1301.30. As authority, the court cited *Darby v. Chambers,*[15] which contains an excellent discussion of the subject.

Discharge of Principal Obligor: Effect On Accommodation Maker

In *Economy Savings & Loan Co. v. Weir,*[16] the court held that where the principal obligor is discharged by reason of an act done by the creditor, the accommodation maker is likewise discharged. The court relied upon Ohio Revised Code section 1303.34 (D),[17] which provides

10. There is an implication in the opinion that the certificates were presented and the disbursements made so promptly that plaintiff's officer should have realized that the construction could not have been completed, but it is doubtful that this was of much significance in the mind of the court. An alternative ground for the decision is based upon an FHA regulation requiring the lender to obtain a written authorization from the borrower if the lender is the payee of the note. The court said that while Nu Homes was nominally the payee, plaintiff, under the circumstances of this case, was the real payee.

11. NEGOTIABLE INSTRUMENTS LAW § 28.

12. BRITTON, BILLS AND NOTES § 99 (1943).

13. Ginn v. Dolan, 81 Ohio St. 121, 90 N.E. 141 (1909).

14. 106 Ohio App. 116, 149 N.E.2d 755 (1957).

15. 70 Ohio App. 287, 46 N.E.2d 302 (1942). The Ohio cases are in conflict. There appears to be no reason to cite any more of them here, as they may be easily found.

16. 105 Ohio App. 531, 153 N.E.2d 155 (1957).

17. NEGOTIABLE INSTRUMENTS LAW § 119.