

THE LIABILITY OF A TRANSFEROR BY DELIVERY AND A QUALIFIED INDORSER

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It is the purpose of this paper to discuss the liability of a transferor by delivery and a qualified indorser of negotiable instruments. Questions pertaining to the remedy, the parties to whom liabilities run, the statute of limitations, measure of damages, rescission by a creditor against his debtor who has transferred paper of insolvent obligors in payment of precedent or contemporaneous debts, and problems involving the liability of an unqualified indorser, as a vendor, are excluded. These aspects of the general problem will be discussed in separate articles. This leaves for consideration the question as to the right of such a transferee to recover from his transferor when the reason for non-payment by prior parties, or any of them, was because of some defense, real or personal, or because of the existence of an outstanding legal or equitable ownership in a third party.¹

A word on terminology. The writer has used the word "warranty" throughout this paper not in any restricted or technical sense but merely as a convenient verbal label for the substantive right of the transferee against his transferor, whether such right is actually to sue for breach of a technical warranty or to sue for what was parted with as a result of rescission based on breach of warranty, mistake of fact or otherwise. Also, the term "transferor" is used to include the transferor by delivery and the qualified indorser, or indorser without recourse, and to exclude the transferor who is an unqualified indorser. The term "vendor" is used as a synonym for "transferor," as above defined. So also is the term "seller" used as a synonym for "vendor" and "transferor." Hence, when the terms "vendor" or "seller" are used it is not intended to suggest that there is any difference between selling a bond, for example, and transferring a note or check of a third party in payment of a precedent or contemporaneous debt. This question does arise, of course, but in the section where it is discussed the context makes allow-

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¹ The phrasing of the problem discussed in this article makes use of Professor Chafee's suggestion developed in his excellent paper, *Rights in Overdue Paper* (1918) 31 HARV. L. REV. 1104, and in his edition of BRANNAN, *THE NEGOTIABLE INSTRUMENTS LAW* (4th ed. 1926) § 55.

ance for the variation in usage. The terms "transferee," "vendee," and "buyer" thus take care of themselves.

The paper seeks to do three things: first, to state the common law on the subject; second, to inquire into the reasons for results. The courts have used two lines of thought in reaching results. One is drawn from the cases on chattels where ideas of defect in quality and defects other than of quality—of description, identity, and the like—are used. This paper criticises this usage, and does so on the basis of the actual decisions and of judicial opinion. For the opinions themselves, oftentimes, will cut through this verbiage, even after using it, and assert simply that a vendor warrants that the instrument is legally enforceable against all prior parties. It is believed that this is a just result and a desirable form of statement. There is one possible extension, the question whether the vendor should warrant against personal defenses to holders in due course. If this be added, then, of course, the vendor warrants something more than the enforceability of the instrument against all prior parties. This will be discussed. These points come to focus best in the sections on illegality and personal defenses.

This sort of inquiry leads to the suggestion that the law fixing the liability of the vendor should be perfectly synchronized with the law which establishes defenses and equities of ownership. If the transferee cannot get his money from any prior party because that party has a defense, he ought to be able to get it from his transferor. If the suggested re-phrasing of the warranty rule is made, he will have a right to get it from his transferor. There cannot be any "slip-up" here as there is when the transferor's warranties are said to be that the instrument is "genuine" and "in all respects what it purports to be"—the language of many common law cases, loose enough even there, but now, unfortunately, in the Statute. That is, this is so unless it can be changed. And this is the third object of this review of the subject, to suggest the amendment of Section 65 of the Negotiable Instruments Law so that it will more clearly reflect the common law, which, on the whole, produced just results. Such re-phrasing would serve the further purpose of rendering results more predictable, settlements quicker, and litigation less likely. This accounts for the organization of the subject around the specific real defenses, and the separate consideration of warranties against personal defenses.

Forgery

A transferor by delivery is liable to his transferee if the instrument is forged. As stated in an early American case:

"When a person sells a note he is always understood as affirming that it is what it purports to be; that is, that it is a genuine

note. If it is not what it purports to be it is nothing, and may be treated as a nullity; and it is not material whether it be given in payment of an antecedent debt, or in exchange for goods immediately sold and delivered, or to be sold and delivered at a subsequent day. In the first case it would be no payment; in the second and third cases there would be a total failure of consideration; and the party who had parted with his property in expectation of a consideration which has failed, may resort to his original cause of action. . . . No one who purchases a note ever thinks of taking upon himself the risk of its being a forgery."²

Numerous cases, of course, support this proposition.³

A forged acceptance of the drawee has the same effect on the liability of the transferor as does that of a maker's name. In the leading English case of *Gurney v. Womersley*,⁴ the plaintiff, who discounted a bill on which the drawer's and acceptor's names were forged, recovered from his transferor. Lord Campbell said: "I am of opinion that though the defendants, by not indorsing or guaranteeing the bill, preserved themselves from warranting the solvency of any of the parties, yet they did undertake that the instrument was what it purported to be."⁵ It was argued for defendant, that "the defendants should be taken to warrant only those things within their own knowledge."⁶ The court does not discuss this point, though recovery was allowed, there being no disclosure of evidence that the defendant knew of the forgery. And Coleridge, J., added: "The vendor of a specific chattel, it is not disputed, is responsible if the article be not a genuine article of that kind of which the seller

² *Semmes v. Wilson*, Fed. Cas. No. 12, 658 at 1061 (1837). Or, as stated in *Lyons v. Miller*, 6 Grat. 427, 440 (Va. 1849): "By declining to endorse, the defendant . . . could not . . . avoid the responsibility of warranting the genuineness of the instrument."

³ *Dana v. Angel*, 1 Hawaii 319 (1855); *Bell v. Cafferty*, 21 Ind. 411 (1863); *Waller v. Staples*, 107 Iowa 738 (1898) (forged mortgage); *Snyder v. Reno*, 38 Iowa 329 (1874); *Smith v. McNair*, 19 Kan. 330 (1877); *Cluseau v. Wagner*, 126 La. 375, 52 So. 547 (1910); *Thompson v. McCullough*, 31 Mo. 224 (1860); *Hunt v. Sanders*, 288 Mo. 337, 232 S. W. 456 (1921) ("immaterial whether defendant knew or did not know the paper was forged;" under N. I. L.); *Herrick v. Whitney*, 15 Johns. 240 (N. Y. 1818); *Shaver v. Ehle*, 16 Johns. 201 (N. Y. 1819); *Lyons v. Diveibis*, 22 Pa. 185 (1853); *West Philadelphia National Bank v. Field*, 143 Pa. 473 (1891); *Barton v. Trent*, 3 Head. 167 (Tenn. 1859); *Lyons v. Miller*, *supra* note 2.

The same result has been reached where the instrument is signed by one having no authority to bind the principal. *Swanzy v. Parker*, 50 Pa. 441 (1865); *Flynn v. Allen*, 57 Pa. 482 (1868). *Contra*: *First National Bank v. Drew*, 191 Ill. 186, 60 N. E. 856 (1901), criticised in 1 WILLISTON, CONTRACTS (1920) § 445, n. 6.

⁴ 4 E. & B. 133 (1854).

⁵ *Ibid.* 143.

⁶ *Ibid.* 140.

represents it to be. And the question raised really is, What is the extent of the want of genuineness for which he is responsible? Without laying down the limits, it is clear to me that this case fell much within them."⁷

An indorser without recourse, just as the transferor by delivery, is liable to his indorsee if the maker's name was forged.⁸

The implied warranty of genuineness, thus worked out by the common law cases, is codified by Section 65 of the Negotiable Instruments Law. This Section provides: "Every person negotiating an instrument by delivery or by a qualified indorsement, warrants,—(1) that the instrument is genuine and in all respects what it purports to be."⁹ The typical situations, as they appear in the preceding common law cases, should be held the same under Section 65 simply by interpreting and applying the first clause, *i.e.*, the warranty "that the instrument is genuine." Thus far, there would be no necessity for making use of the warranty that the instrument is "in all respects what it purports to be"—an expression which, as indicated in the above cases, was frequently used at common law. The corresponding language of the English Bills of Exchange Act is set out in the note.¹⁰

Fraud as a Real Defense

Is an instrument forged, *i.e.*, not genuine, within the meaning of the above rule, when the signature was affixed, not by a third party, but by the party whose name is signed, under circumstances where he did not know the character of the instrument which he signed, and was not negligent in not finding out?¹¹

⁷ *Ibid.* 140, citing *Jones v. Ryde*, 5 Taunt. 488 (1814). See *infra* note 26.

⁸ *Palmer v. Courtney*, 32 Neb. 773, 49 N. W. 754 (1891); *Hall v. Lattimer & Son*, 81 S. C. 90, 61 S. E. 1057 (1908).

⁹ *Cluseau v. Wagner*, 126 La. 375, 52 So. 547 (1910); *Hunt v. Sanders*, 288 Mo. 337, 232 S. W. 456 (1921).

¹⁰ § 58 provides: "(1) Where the holder of a bill payable to bearer negotiates it by delivery without indorsing it, he is called a 'transferor by delivery.' (2) A transferor by delivery is not liable on the instrument. (3) A transferor by delivery who negotiates a bill, thereby warrants to his immediate transferee, being a holder for value, that the bill is what it purports to be, that he has a right to transfer it, and that at the time of transfer he is not aware of any fact which renders it valueless." The English Act makes no special provision for the liability of the qualified indorser, but it is possible that his liability would be controlled by § 58. A qualified indorser is not really an indorser; the words used simply destroy his liability as an indorser. Not being an indorser, he would be whatever the Act chose to call him. And in the English Act, he may thus be called a transferor by delivery.

¹¹ When the maker is negligent in not finding out what he is signing his signature is genuine and he is liable upon it. *Foster v. MacKinnon*, L. R. 4 C. P. 704 (1869). The rule is generally followed in America.

No cases have been found on this point. It is believed that the vendor of such an instrument would be liable. The instrument is no more genuine than in the typical case of forgery—assuming of course that the signer was not negligent in so signing.

Inasmuch as the distinctions drawn in *Foster v. MacKinnon* and the American cases,¹² as to the liability of the maker when negligent, are likely to be observed under the Negotiable Instruments Law,¹³ it would seem that where the signer is held not liable, the instrument would be held “not genuine” under Section 65, and the transferee could recover. This result, however, could be reached under the Statute in another way. Since the signature was put there by the party himself it could be said to be “genuine,” ignoring intent as an element thereof. But the defense may none the less be held real, *i.e.*, good as against holders in due course—the situation being discussed—although in that case it would not be called forgery but fraud in the in-

But that phase of it which frees the maker from liability in cases of non-negligent execution has been repudiated in West Virginia and, possibly, Connecticut. *Tower v. Whip*, 53 W. Va. 158, 44 S. E. 179 (1903); *Bank of Parkersburg v. Johns*, 22 W. Va., 520 (1883); *Rowland v. Fowler*, 47 Conn. 347 (1879). The American cases are collected and discussed in an article by the present writer, *Fraud in the Inception of Bills and Notes* (1924) 9 CORN. L. Q. 138.

As to what constitutes negligence the cases seem to decide that where the signer is not able to read, because of illiteracy, defective vision, or otherwise, there being no third party present or readily available, the signer will not be negligent in relying upon a statement of the adverse party as to the contents of the writing signed by him; but if a third party is present or readily available, who is not associated with the adverse party, the maker will be negligent if he does not request such third party to read the contents of the instrument to him. Where such signer is able to read and does not do so but relies upon the statement or purported reading by the adverse party, he will be deemed negligent.

The cases do not make clear just what it is that a signer must know before he has “contractual intent.” Sometimes he may sign an instrument not knowing that he is signing that piece of paper at all, as, for example, when he signs a receipt and by the fraudulent and artful use of carbon paper his signature is traced on a note. There is no contractual intent here. An illiterate person signs what he is told is a contract employing him. There is frequently no contractual intent in such case. On the other hand, he would have contractual intent although he did not know the law of bills and notes. Probably what is meant is that he must know, or had he read could have known, that he was making a promise or order to pay money. As a practical matter such fact can be determined, however puzzling the theoretical aspect of the problem may be.

¹² See *supra* note 11.

¹³ *Lewis v. Clay*, 67 L. J. Q. B. (N. S.) 224 (1897); *Foster v. MacKinnon*, *supra* note 11, still law in England and followed in *Alloway v. Hrabí*, 14 Man. L. R. 627; *Royal Bank v. Wannamaker*, 4 D. L. R. 999 (Ont. 1929); also followed, since the Negotiable Instruments Law, but not cited, in *First National Bank of Shenandoah v. Hall*, 169 Iowa 218, 151 N. W. 120 (1915), and in *Bothell v. Miller*, 87 Neb. 835, 128 N. W. 628 (1910).

ception, or fraud in the factum, or anything else to distinguish it from that kind of fraud which operates only as a personal defense. The only difficulty here is to find the statutory basis for such a real defense. The Negotiable Instruments Law expressly deals with the real defenses of forgery, material alteration, and non-delivery of an incomplete instrument, but does not deal specifically with the real defense based on fraud or illegality. The Wisconsin¹⁴ and Illinois¹⁵ Acts expressly preserve the real defense arising from the kind of fraud under discussion. A separate statute in Minnesota¹⁶ probably accomplishes the same result. In other states, the defense is either not real, or will have to be worked out as such, first, by so interpreting Sections 55 and 57 that this kind of defense does not fall thereunder and become personal, and second, by treating it as a *casus omissus*, and hence controlled by the common law rule, incorporated by reference into the Negotiable Instruments Law through Section 196. If this course were followed, then the last clause of Section 65 would apply to create the warranty, since the instrument, being subject to a real defense, would not be "in all respects what it purports to be." For, whatever the outer limits of the meaning of this language may be, it would seem at least to impose a warranty against all real defenses so closely allied to that of forgery. On the whole, however, it would seem more logical and desirable to treat this kind of real defense as forgery. An instrument so signed cannot be considered "genuine."

There is another solution, erroneous and undesirable, it is believed, but perhaps possible under the Act. If such an instrument is deemed "genuine," and the clause "in all respects what it purports to be" is deprived of all meaning and treated as a repetition of the idea of genuineness, then the instrument might be called "invalid." The warranty against facts constituting invalidity is governed by Section 65(4). And here the only warranty defined is, that the vendor "has no knowledge of any fact which would impair the validity of the instrument or render it valueless." The answer to this solution has already been made. If there is a warranty against the real defense of forgery, there should be a warranty against any other defense which operates as forgery.

Certain analogous situations may be referred to in passing, but not for discussion at this time. This has been done elsewhere.¹⁷ It is here intended to exclude the *Price v. Neal* prob-

¹⁴ By addition to § 55 of the Negotiable Instruments Law.

¹⁵ By express incorporation of an older statute in § 57 of the Negotiable Instruments Law.

¹⁶ MINN. STAT. (Mason, 1927) § 6015.

¹⁷ Ames, *The Doctrine of Price v. Neal* (1891) 4 HARV. L. REV. 297;

lem—the question as to when a drawee or acceptor of a bill bearing the forged signature of the drawer may recover from the transferor—also, to exclude consideration of the right of such parties to recover money paid out on instruments bearing forged indorsements, or on materially altered instruments, or on genuine instruments accompanied by forged bills of lading, or on genuine bills of drawers who had no funds with the drawee. In these cases the instrument is transferred for final payment. In the cases under discussion the transfer involved does not end the life history of the instrument. The only occasion for mentioning these problems at all is to point out a twilight zone between them and the subject of this paper. Sometimes it is difficult to determine whether a transferee, who, in a sense, is in an anomalous position, should be put in the one class or in the other. Specifically, where an instrument is drawn on *D*, but made payable at bank *X*, and *X* takes up the instrument, in which class does *X* belong?¹⁸ A similiar situation

Aigler, *The Doctrine of Price v. Neal* (1926) 24 MICH. L. REV. 809; BRANNON, *op. cit. supra* note 1, at § 62.

¹⁸ *Smith v. Mercer*, 6 Taunt. 76 (1815), where a bill drawn on *A*, payable at the plaintiff's bank, was paid by the plaintiff to the defendant under *A*'s forged acceptance. The plaintiff could not recover. He was not considered as a transferee but was held to be in the same position as the acceptor, so that *Price v. Neal*, 3 Burr. 1354 (1762), controlled. The court said: "If an acceptor is then bound to know the drawer's handwriting, is it less the duty of a banker to know the handwriting of his customer?" *Ibid.* 81. One judge thought that *Jones v. Ryde*, *supra* note 7, should control. And *cf. Fuller v. Smith*, 1 Car. & P. 197 (1824), which might be considered *contra*.

In *Cocks v. Masterman*, 9 B. & C. 902 (1829), it was apparently assumed that the bank at which the bill was made payable by the acceptor could recover from the party to whom payment was made under the forged acceptance of the drawee. But in this case recovery was denied because notice of the forgery was not given to the transferor until the day after payment. This point of course has an important bearing on the *Price v. Neal* problem. But the court did not refer either to *Price v. Neal* or *Smith v. Mercer*, though both cases were cited in argument. The case was followed in *London & River Plate Bank v. Bank of Liverpool*, [1896] 1 Q. B. 7.

The rule was not applied in *Leeds & County Bank v. Walker*, L. R. 11 Q. B. D. 84 (1883), because the altered instrument there was a bank of England note and the holder was prejudiced because there were no indorsers. Nor was it followed in *Imperial Bank of Canada v. Bank of Hamilton*, [1903] A. C. 49, a case of an altered check. Here the giving of notice did not bar the drawee's right of recovery because the court found there were no indorsers. Nor was the defendant prejudiced as against the drawer because it was he who had raised the check after certification.

Whether a bank at which a forged note is made payable can recover from the last holder will depend on the interpretation of § 87 of the Negotiable Instruments Law which provides generally that such an instrument "is equivalent to an order on the bank to pay the same for the account of the principal debtor thereon." As tending to deny recovery, see *Citizens Bank v. Schwartzchild & S. Co.*, 109 Va. 539, 64 S. E. 954 (1909). As tending

arises where an acceptor or payor for honor takes up the instrument.¹⁹ Is such party in the position of the drawee, or is he to be treated as an ordinary transferee who is in no way a payor? There may be other situations of similar nature.²⁰

Counterfeit Bank Bills

Transfers of counterfeit coins and bank bills are subject to the same general rule as that which governs forged paper of private persons. Coke once expressed the opinion that the transferee of coins assumed the risk of their being counterfeit,²¹ and on the basis of this statement it has been argued that the transferee of counterfeit bank bills assumed the same risk. Chancellor Kent, however, instead of following the implication from Coke's dicta, went to the Roman and French law for the rule which throws the risk on the transferor.²²

to support the right of recovery, see *Mt. Morris Bank v. Twenty-third Ward Bank*, 172 N. Y. 244, 64 N. E. 810 (1902).

¹⁹ A payor for honor of an indorser of a forged bill was allowed to recover in *Wilkinson v. Johnson*, 3 B. & C. 428 (1824). The plaintiff relied on *Jones v. Ryde*, *supra* note 7, and *Bruce v. Bruce*, 1 Marsh. 165 (1814). The defendant relied on *Price v. Neal* and *Smith v. Mercer* but the court thought the case was like *Bruce v. Bruce*. But an acceptor for honor of the drawer of a bill bearing the forged signature of the drawer was held liable to the holder in *Phillips v. Im Thurn*, L. R. 1 C. P. 463 (1866). In *Goddard v. The Merchants Bank*, 4 N. Y. 147 (1850), a payor for honor of the drawer, the drawer's name being forged, was allowed to recover. The court took the case out of the *Price v. Neal* rule solely on the narrow ground that payment was made by the plaintiff who had not seen the bill. Two judges dissented. The distinction resting on the fact that payments are made without seeing the bill was criticized in *Bernheimer v. Marshall*, 2 Minn. 61 (1858), and *Johnson v. Bank*, 27 W. Va. 343 (1885).

²⁰ For example, *State v. Merchants National Bank*, 145 Minn. 322, 177 N. W. 135 (1920) ("payment" by state depositors of bills drawn by and on state agencies).

²¹ In *Wades case*, 5 Coke 114, Coke said: "And it was said that it was adjudged between Vane and Studley, that where the lessor demanded rent of his lessee according to the condition of re-entry, and the lessee paid the rent to the lessor, and he received it; and put it in his purse, and afterwards looking it over again at the same time, he found amongst the money that he had received some counterfeit pieces, and thereupon he refused to carry away the money, but re-entered for the condition broken: and it was adjudged that the entry was not lawful; for when the lessor had accepted the money, it was at his peril, and after that allowance he shall not take exception to any part of it." The same idea is found in *SHEPHERD, TOUCHSTONE* 140.

²² *Markle v. Hatfield*, 2 Johns. 455 (N. Y. 1807), where Chancellor Kent criticises the statements of Coke as "ancient dicta in the English law." Cf. also *Ramsdale v. Horton*, 3 Pa. 330 (1846): "Payment in counterfeit notes or base coin, is, in effect, no payment at all; and as the debt remains, the creditor's recourse for it is to the debtor on the original cause of action." Accord: *Union National Bank of Chicago v. Baldenwick*, 45 Ill. 375 (1867); *Keene v. Thompson*, 4 G. & J. 463 (Md. 1832); *Buck v. Doyle*, 4 Gill 478

Return of the counterfeit bill within a reasonable time after discovery of its invalidity has been held a condition precedent to the liability of the transferor.²³ But there are cases to the contrary²⁴ as well as cases excusing non-performance of the condition precedent.²⁵

Material Alteration

Lack of genuineness results from material alteration as well as by forgery of the name of a primary party. In the leading English case of *Jones v. Ryde*,²⁶ the transferee of a government navy bill issued for 884 £. and fraudulently raised to 1884 £. was allowed to recover from his transferor 1000 £.—the 884 £. having been voluntarily paid to him by the government—in an action for money had and received. The defendant had no knowledge of the alteration. Replying to the argument that the defendant, not having indorsed, was not liable, Gibbs, C. J., said:

“This question was much mooted in *Fenn v. Harrison*,²⁷ and it is true to a certain extent, viz.—if he who negotiates it does not indorse it, he does not subject himself to that responsibility which the indorsement would bring on him . . . but his declining to indorse the bill does not rid him of that responsibility which

(Md. 1846); *Hargrave v. Dusenberry*, 9 N. C. 326 (1823); *Anderson v. Hawkins*, 10 N. C. 568 (1825); *Lowe v. Weatherley*, 20 N. C. 212 (1839); *McDonald v. Allen*, 67 Tenn. 446 (1874); *Chalmers v. Harris*, 22 Tex. 265 (1858); *Reeves v. Avina*, 201 S. W. 729 (Tex. Civ. App. 1918) (counterfeit Mexican money); *Pindall's Ex'ors v. The Northwestern Bank*, 7 Leigh 617 (Va. 1836); *Cassedy v. Williams*, Fed. Cas. No. 2501 (C. C. D. C. 1843).

²³ *Thomas v. Todd*, 6 Hill 340 (N. Y. 1844) (delay of about two months barred rescission); *Lawrenceburg National Bank v. Stevenson*, 51 Ind. 594 (1875) (delay of a year barred recovery); *Simms v. Clark*, 11 Ill. 137 (1849); *Young v. Adams*, 6 Mass. 181 (1810).

²⁴ *Kent v. Bornstein*, 12 Allen 342 (Mass. 1866); *Perley v. Balch*, 23 Pick. 283 (Mass. 1838). “In *Coolidge v. Brigham*, 1 Met. 547 [Mass. 1840] . . . the promissory note was not worthless, for while the indorsements upon it were forged, the signature of the maker was genuine.” *Brewster v. Burnett*, 125 Mass. 68, 70 (1878).

²⁵ A delay of two months was excused in *Burrill v. The Watertown Bank & Loan Co.*, 51 Barb. 105, 112 (N. Y. 1867), where Morgan, J., after referring to *Thomas v. Todd*, *supra* note 23, said: “I am not satisfied that the law creates an absolute duty upon the creditor to return forged bank paper to his debtor before he is allowed to sue him upon an implied warranty of genuineness.” The rule is discussed in *Kenny v. First National Bank of Albany*, 50 Barb. 112 (N. Y. 1867).

²⁶ *Supra* note 7; followed in *Bruce v. Bruce*, *supra* note 19.

²⁷ 3 T. R. 757. *Cf.* *First National Bank v. Gridley*, 112 App. Div. 398, 98 N. Y. Supp. 445 (2d Dep't 1906) (no warranty against subsequent alterations).

attaches on him for putting off an instrument as of a certain description, which turns out not to be such as he represents it."²⁸

This case was followed and relied upon in *Leeds & County Bank v. Walker*,²⁹ where a transferee who had received Bank of England notes, altered as to number and amounts, in payment of his obligation held by the transferor was allowed to recover. The additional argument for the defendant, that the plaintiff should not recover because of his delay of five days in giving the defendant notice of the Bank of England's refusal to pay the notes, was rejected. The court recognized that failure to give notice of dishonor either of a forged bill, such as in *Cocks v. Masterman*,³⁰ or of a genuine bill, such as in *Camidge v. Allenby*,³¹ would bar a transferee's right of recovery from his transferor. But it was thought that such cases did not apply "to a forged Bank of England note upon which no other person could be liable except the bank itself and in the case of which there is nothing to prevent the person sued for the money paid in error from suing the person to whom he may have given cash in error, and so on ad infinitum, subject only to the statute of limitations." American cases are in accord.³²

A question of the amount of recovery may be involved. In the United States, at common law, when the alteration was not fraudulent recovery could be had in some states on the instrument as it was prior to alteration. In others recovery was allowed on the original debt. Where the alteration was fraudulent no recovery could be had, either on the instrument as it was prior to alteration or on the original consideration.³³ At common law, therefore, the damage to the holder depended on whether the alteration was fraudulent or innocent. If fraudulent the loss was the total value of the consideration paid by him. If innocent, it was this value less what he could recover from the maker, drawer or acceptor. And it would seem from *Jones v. Ryde* that even if such party voluntarily paid the amount of the original debt, waiving the defense of alteration,

²⁸ 5 Taunt. at 492.

²⁹ *Supra* note 18.

³⁰ *Supra* note 18.

³¹ 6 B. & C. 373 (1827).

³² *Snyder v. Reno*, *supra* note 3, at 333: "Such material alteration . . . is forgery, both at common law and under our statute. And we have no doubt that there is an implied warranty of the transferer that there is no such defect in the instrument, as well as that the signature of the maker is genuine." Accord: *Birmingham National Bank v. Bradley*, 103 Ala. 109 (1893) (indorser "warranted . . . the amount [which had been altered] expressed in the check").

³³ These cases are cited and discussed in 3 WILLISTON, CONTRACTS (1920) §§ 1911, 1893.

the amount of the holder's recovery from his transferor would be cut down to this extent.

Under the Negotiable Instruments Law distinctions between innocent and fraudulent alterations are apparently abolished. Section 124 provides: "Where a negotiable instrument is materially altered without the assent of all parties liable thereon, it is avoided, except as against a party who has himself made, authorized, or assented to the alteration, and subsequent indorsers." If under this Section holders not in due course cannot recover, either upon the instrument or original debt, where the alteration is innocent, it would seem that the vendor would be liable for the full consideration paid to him by the vendee, except where the vendee was not a holder in due course because he knew of the alteration, in which case there would be no warranty. But as regards the rights of a holder in due course, Section 124 provides: "But when an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor." Whether innocent or fraudulent, this right of the holder in due course would reduce the amount recoverable from his transferor or indorser without recourse.

Section 65(1) of the Negotiable Instruments Law, it is believed, imposes the warranty against prior material alterations. If the material alteration creates a real defense, available against holders in due course, to the extent above indicated, to that extent the instrument is not "genuine." Nor is it "in all respects what it purports to be." The common law cases quite commonly use the word "forgery" to describe material alterations. Such an instrument therefore could not be "genuine," as the term is used in Section 65(1), and there would probably be no need to resort to the last clause of the Section for the statutory basis for the warranty against material alterations.³⁴

If the instrument has been altered, not by erasures and substitutions, but by the insertion of words and figures in blank spaces negligently left by the maker or drawer in a completed instrument—the *Young v. Grote*³⁵ problem—the liability of the vendor would turn on the question whether such negligence operates to estop the maker or drawer from setting up the defense of material alteration as against the holder. At common law there was a conflict of authority on this point. In some

³⁴ Alterations not material do not create defenses. As to what alterations are deemed material see WILLISTON, *op. cit.*, *supra* note 33, at § 1902 *et seq.*

³⁵ 4 Bing. 253 (1827).

states the holder in due course was allowed to recover. The majority held otherwise.³⁶

The Negotiable Instruments Law unfortunately does not deal with the effect of negligent execution. The conflict can thus continue under the Act. Under Section 65(1) it would seem that wherever the holder in due course could not recover free from the defense of material alteration his vendor would be liable to him, such an instrument not being "genuine." In other jurisdictions, where the holder in due course may be allowed to recover from the maker or drawer, he could not recover from his transferor as the instrument would be "genuine" under Section 65(1). This result is on the theory that a vendor merely warrants the existence of such facts as will enable his vendee to recover from the maker, drawer or acceptor. If he warrants against the existence of personal defenses, even to holders in due course, a question discussed later, the result would, obviously, not turn on the question whether or not the vendee was a holder in due course. If the vendor warrants against personal defenses, then in both cases the instrument would not be "genuine" under Section 65(1).

Non-delivery

No cases have been found which deal with the question whether the vendor warrants that the instrument is not subject to the defense of non-delivery. There is little reason to doubt that he would so warrant if the defense is real. Another question enters if it is personal. At common law the non-delivery of an incomplete instrument was a real defense.³⁷ And most courts held that the non-delivery of a completed instrument was also a real defense.³⁸ But it was also held that the non-delivery of a completed instrument was a personal defense,³⁹ even when the instrument got into circulation by larceny. And some courts held that the defense was real if it got into circulation through no negligence of the maker or drawer, but was personal if his negligence contributed to its escape.⁴⁰

The Negotiable Instruments Law codified the common law rule on incomplete instruments by making such facts a real defense. Section 15 provides: "Where an incomplete instrument has not been delivered it will not, if completed and negotiated,

³⁶ The cases are cited and discussed in an article by the present writer, *Negligence in the Law of Bills and Notes* (1924) 24 COL. L. REV. 695.

³⁷ *Baxendale v. Bennett*, L. R. 3 Q. B. D. 525 (1878); *Nance v. Lary*, 5 Ala. 370 (1843).

³⁸ *Burson v. Huntington*, 21 Mich. 415 (1870).

³⁹ *Clarke v. Johnson*, 54 Ill. 296 (1870).

⁴⁰ *Salley v. Terrill*, 95 Me. 553, 50 Atl. 896 (1901); *Phillips v. Joy*, 114 Me. 403, 96 Atl. 727 (1916).

without authority, be a valid contract in the hands of any holder, as against any person whose signature was placed thereon before delivery." But with respect to the non-delivery of a completed instrument, the contrary was provided, thus codifying the minority rule. Section 16 declares, with respect to completed instruments, that "where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him so as to make them liable to him is conclusively presumed."

It is clear, therefore, that non-delivery of a completed instrument is always a personal defense. It is not a real defense even where the maker was not negligent in his custody of it after execution. It is clear also that the non-delivery of an incomplete instrument will always be a real defense, unless the courts should read into Section 15 the qualification that a maker or drawer who was negligent in the custody of the instrument after partial execution was estopped to set up the defense of non-delivery, just as some courts have held that by negligent execution, contributing to a subsequent alteration by insertions, a maker or drawer is estopped from setting up the defense of material alteration as against the holder in due course.⁴¹

The basis for the assumption that, at common law, the vendor warranted against the real defense of non-delivery of an incomplete instrument, and of non-delivery of a completed instrument, where that rule obtained, is that the law made delivery just as important a requisite to the existence of the contract as was that of execution. If the vendor warranted against forgery, it was because the instrument so sold never was the maker's, drawer's or acceptor's contract. Where there was a genuine signature but no delivery, it was still not the signer's contract. It would seem that the vendor would necessarily warrant against this real defense. Discussion of the question as to whether there was a warranty against the defense of non-delivery when that defense was personal, or when, though real, there was an estoppel by negligence to set it up, is postponed.

Under the Negotiable Instruments Law, it is believed there is also a warranty against the defense of non-delivery of an incomplete instrument. Section 15 declares that, in such situation, it is not "a valid contract in the hands of any holder." Section 65(1) provides that there is a warranty "that the instrument is genuine and in all respects what it purports to be."

⁴¹ Some courts will apparently treat the defense as real, irrespective of negligence. *Holzman, Cohen & Co. v. Teague*, 172 App. Div. 75, 158 N. Y. Supp. 211 (1st Dep't 1916); *Linick v. Nutting & Co.*, 140 App. Div. 265, 125 N. Y. Supp. 93 (2d Dep't 1910). Others will not. *Phillips v. Joy*, *supra* note 40; *Allen Grocery Co. v. Bank of Buchanan Co.*, 192 Mo. App. 476, 182 S. W. 777 (1916).

It might be possible to say that an incomplete instrument stolen from the maker or drawer was not a "genuine" instrument within the meaning of this Section. But if such instrument, for purposes of argument, is admitted to be genuine, the last clause would impose the warranty, for certainly an instrument which "is not a valid contract in the hands of any holder," is not "in all respects what it purports to be." This clause was doubtless inserted to cover just such cases, situations too numerous to mention in detail in the Statute, but, in legal effect, analogous to non-genuine instruments. What does such an instrument "in all respects purport to be?" If in addition to the content of the word "genuine," this clause means anything at all, it means that there is a warranty that the instrument is then an enforceable legal obligation of the parties whose names appear thereon. What else can it purport to be?⁴² The narrowest meaning would be that there is a warranty that the instrument would be an enforceable legal obligation against prior parties, in the hands of this vendee. On this construction, if the vendee were a holder in due course, there would be no warranty against the defense of non-delivery of a completed instrument, or of the defense of non-delivery of an incomplete instrument where there was held to be an estoppel by negligence to set up such defense, because the vendee could recover from prior parties. The widest meaning would be that it was warranted to be the enforceable legal obligation of all prior parties in the hands of any holder, whether in due course or not, so long as he did not know of this defense. On this construction the holder in due course could elect whether to recover from primary parties, or whether to hold his vendor. Discussion of this question is postponed. It is fairly clear at this point that at least there is a warranty against the defense of non-delivery of an incomplete instrument when this defense is real.

Incapacity

If a transferor by delivery and an indorser without recourse assume the risk of forgery of a primary party's name, of material alterations, and of non-delivery of incomplete instruments,

⁴² Of course, if all defenses, real and personal, are to be classified as defects of lack of identity or defects of quality—terms taken from the cases on chattels—then it might be said that the instrument did not purport to be of any particular "quality." There would then be abundant opportunity for disagreement as to when the particular defect was of quality or of lack of identity. This classification is not feasible or desirable with respect to bills and notes as a means of describing the defenses against which there are warranties, and defenses against which there are no warranties. If the term "defect in quality" is to be used at all it should be used merely to describe an enforceable legal obligation which could not be collected from the obligor because of his insolvency or otherwise.

it would seem that they should also assume the risk that prior parties had capacity to contract. And such is the rule. The vendor warrants against the defense of incapacity, such as infancy,⁴³ coverture⁴⁴ and insanity.⁴⁵ While the real defense of incapacity is not specifically dealt with in the Negotiable Instruments Law except by implication in Section 22, dealing only with the contracts of infants and corporations, the above rule is definitely codified in Section 65(3) which provides that: "Every person negotiating an instrument by delivery or by a qualified indorsement, warrants that all prior parties had capacity to contract."

Illegality

Does a transferor by delivery or a qualified indorser warrant against the defense of illegality when such illegality is of the kind which constitutes a real defense? The following cases, it is believed, answer this question in the affirmative. But along with this result it is perhaps of more importance to consider the reasons for it. The illegality cases, together with those on incapacity, present a problem more realistically than do the forgery and material alteration cases. It is sometimes said that there is no warranty of the "quality" of the instrument; that there is no warranty against "latent defects." And then it is said that there is a warranty that the instrument sold shall correspond to the description of the thing as it was referred to in the negotiations between buyer and seller. These general notions appear to have come from the law of sales of chattels, and, on the whole, seem unwisely transplanted. In the forgery and material alteration cases their use causes no harm because the sale of a forged or altered bill can readily be said not to correspond to the description of the subject matter discussed. There is little danger that any court now would hold that the transferee of a forged or altered bill got what he expected to get, or would say that the defect was merely one of quality, though, as noted above, Coke thought that the transferee assumed the risk of coins received in payment being counterfeit. The problem

⁴³ *Lobdell v. Baker*, 3 Metc. 469 (Mass. 1842) (incapacity known to transferor but unknown to vendee); *Brown v. Summers*, 91 Ind. 151 (1883). The express exception to this clause noted in § 65(4) is discussed in the next section.

⁴⁴ *Erwin v. Downs*, 15 N. Y. 575 (1857).

⁴⁵ *Thrall v. Newell*, 19 Vt. 202 (1847). The court said: "This rule [that] there is an implied warranty in every sale that the thing sold is that for which it was sold] . . . seems well applicable to the sale of the written evidence of a liability, where the purchaser is understood to inquire for himself into the ability of the parties to the paper, but usually takes it for granted that the paper is genuine—that it is signed by persons capable of binding themselves." 19 Vt. at 208. The court relied, in part, on *Lobdell v. Baker*, *supra* note 43.

would likely have come up in cases of sales of instruments bearing genuine signatures obtained under circumstances where the signer did not know the character of the instrument which he signed and was not negligent in not learning. And the question would also have arisen on sales of paper not delivered by the obligor. But no cases on the liability of the vendor of such paper have been found. When we come to the cases of sales of paper bearing genuine signatures of persons incapable of contracting, or of persons capable of contracting but who entered into illegal contracts, we have a different situation. In both these cases, in one sense, we have contracts and the law, for reasons of its own, destroys them. It is not like the forgery and material alteration cases where there is absent the consensual element. For this reason, then, enters the question as to whether the "defect" is one of "quality" or of "lack of identity." Conceivably, it may be regarded as either.

In the cases following, it will be noted that the courts have made use of this language in marking out the fields of warranty and no warranty, and the difficulty felt is, at times, apparent. It will also be noted that the difficulty has caused, at times, a virtual abandonment of this terminology as an instrument for segregating the warranty states of fact from the no-warranty states of fact. As an improvement thereon, appears the idea that the vendor's warranties should be described with reference to defenses of prior parties.

It is believed that the decisions justify this change in the expression of the rule. If this proves to be so it would make possible the use of a wide generalization, just in its results and much clearer in meaning than that which was imported from the law of chattels. It could then be phrased: a transferor by delivery and an indorser without recourse warrant against all real defenses of all prior parties. Or to go a step further, the cases may justify the still wider generalization that these parties warrant against all defenses of prior parties whether real or personal, if available against the vendee. If this point is reached, the warranties could then be defined in the affirmative form, that the vendor warrants the existence of all facts necessary to a recovery by the vendee against all prior parties. In short, that the vendor warrants that the instrument is enforceable against all prior parties, or simply, that he can get a judgment against all prior parties. Note that in this form the rule is not confined to warranties against equities of defense but there is brought into the statement the warranty against outstanding equities of ownership, or, as it is usually called, the warranty of title. If the rule were thus stated it would articulate perfectly with Professor Chafee's suggestion that the Negotiable Instruments Law terms of "infirmity in the instrument"

and "defect in title" were poorly chosen and that the ideas might more clearly have been described by the expressions, "equities of defense" and "equities of ownership." It is believed the cases go this far.

There is still another possibility, involving an even wider generalization, but one concerning which there is more doubt, both as to its existence in the cases and as to its wisdom. It could be said that the vendor warrants not only that the instrument is enforceable against all prior parties, but that he warrants that no prior party has a defense, real or personal. Under this form, the vendee, who was a holder in due course as against all prior parties, and therefore so situated that he could get a judgment against each of them, would be privileged to forego this right and recover from his vendor. This question is discussed in a later section.

To take up the authorities: The leading English cases of *Young v. Cole*,⁴⁶ *Lambert v. Heath*,⁴⁷ and, by implication, *Gompertz v. Bartlett*,⁴⁸ hold that there is a warranty, even though the defendant had no knowledge of the illegality. In *Gompertz v. Bartlett*, the vendee of what purported to be a foreign bill, invalid because being a domestic bill it was not stamped, was allowed to recover from the vendor, indorser without recourse, the consideration paid. Lord Campbell said:

"At the trial, I was impressed with the consideration that this was a transaction of pure sale, and that the vendor really had title to the bill which he sold, and was perfectly ignorant of the latent defect . . . and on the whole I was then inclined to think that the defect was merely one in the quality, which the vendor did not warrant. But now . . . I think that the action is maintainable, on the ground that the article does not answer the description of that which was sold, viz., a foreign bill. . . . I think, therefore, that the money paid for it may be recovered as paid in mistake of facts. . . . If being what was sold, the bill was valueless because of the insolvency of the parties the vendor would not be answerable; but he is answerable if the bill be spurious."⁴⁹

American cases are in accord.⁵⁰

In the subsequent case of *Pooley v. Brown*,⁵¹ the difficulty in-

⁴⁶ 3 Bing. N. C. 724 (1837). For discussion of this case see *infra* note 58.

⁴⁷ 15 M. & W. 486 (1846). For discussion of this case see *infra* note 60.

⁴⁸ 2 E. & B. 849 (1853).

⁴⁹ *Ibid.* 853. The court relied on *Jones v. Ryde*, *supra* note 7, and *Young v. Cole*, *supra* note 46.

⁵⁰ See *infra* notes 54 to 76.

⁵¹ 11 C. B. (N. S.) 565 (1862). In *Hall v. Conder*, 2 C. B. (N. S.) 20 (1857), the vendor of a patent was held not to warrant that it was indefeasible. The court thought that because each party had an equal means of ascertaining its value the case did not fall within *Young v. Cole* or *Gompertz v. Bartlett*.

volved in attempting to make the liability of the vendor turn on the question whether the "defect" in the instrument made it of a different description, or was merely one of quality—suggested by Lord Campbell in *Gompertz v. Bartlett*⁵²—is again illustrated. In this case a bill drawn in Belgium payable in London was indorsed without recourse by the defendant to the plaintiff. The law required the cancellation of the stamp thereon under penalty of invalidity. Neither party did so and as a result the acceptor was not liable. The court held that the plaintiff could not recover from his indorser without recourse. Two judges based their decision on the ground that there was no failure of consideration because the plaintiff got the specific things which were the subject of the contract. This distinction is here plausible because the invalidity did not arise until the plaintiff got the bill. These judges also introduced the idea of the defendant's change of position as a separate ground for denial of the plaintiff's right to rescind. They thought that the delay of one year in making presentment, the acceptor having become bankrupt in the meantime, "prejudiced the vendor as to his position in respect both of the drawer and acceptor" and was therefore an added reason for denying the plaintiff's right to sue. And one other member of the court considered the element of delay to be the only ground on which plaintiff should be defeated. Except for the delay this judge thought that the case would be governed by *Gompertz v. Bartlett*.

Invalidity of Government and Private Securities

A type of case, somewhat allied both to the foregoing and to the incapacity cases, raises the question as to when there should be a warranty of the validity of government and private securities, other than ordinary bills and notes. Under the doctrine of the cases just noted there would be such a warranty; but new factors enter, *i.e.*, the possibility of discovering that the securities had not been issued in compliance with statutory provisions, and perhaps certain considerations of public policy.

First, as regards the sale of public securities. Many authorities hold that a vendor of public securities does not warrant their validity, at least under all circumstances. One of the leading cases is that of *Otis v. Cullum*,⁵³ wherein the Supreme Court of the United States held that the vendor of municipal bonds issued under an unconstitutional statute was not liable to his vendee. The Court said:

⁵² *Supra* note 48. From the last sentence quoted from that case Lord Campbell would seem to have abandoned the classification as a test of liability.

⁵³ 92 U. S. 447 (1875).

"... the plaintiffs [purchasers] got exactly what they intended to buy. . . . Such securities throng the channels of commerce, which they are made to seek, and where they find their market. They pass from hand to hand like bank notes. The seller is liable *ex delicto* for bad faith; and *ex contractu* there is an implied warranty on his part that they belong to him and that they are not forgeries. Where there is no express stipulation there is no liability beyond this. . . . It would be unreasonably harsh to hold all those through whose hands such instruments may have passed liable."⁵⁴

As indicated in the note,⁵⁵ *Otis v. Cullum* has been often relied upon to defeat liability of vendors of public securities which for one reason or another were deemed "invalid." Usually the facts which constitute the "invalidity" are set forth but vaguely in the cases. Just what is actually decided, therefore, is a matter of some doubt. And particularly in view of the subsequent case of *Meyer v. Richards*⁵⁶ are the limits of the rule in

⁵⁴ *Ibid.* Compare the case of *First National Bank v. Drew*, *supra* note 3, where the assignee of claims of a contractor for public work against the taxing district, not paid by the district because the assessment did not produce sufficient funds, could not recover from his assignor. The court relied on *Otis v. Cullum* and *Littauer v. Goldman*, 72 N. Y. 506 (1878).

⁵⁵ *White v. Robinson*, 50 Mich. 73, 14 N. W. 704 (1883), holding that the transferor of school orders was not liable to his transferee, it appearing that "the school officers exceeded their authority." The court said: "A sale of genuine documents may involve a warranty of title but we do not think it involves any warranty that the officers had lawful authority to act in the given case." The court relied on *Otis v. Cullum*. Note also *Ruohs v. Bank*, 94 Tenn. 57, 28 S. W. 303 (1894), where the transferor of municipal bonds, unenforceable because issued under an unconstitutional statute, was held not liable to his purchaser. The court relied on *Lambert v. Heath*, 15 M. & W. 486, *infra* note 60, and *Otis v. Cullum*. Accord: *First National Bank v. Oldham*, 74 Tenn. 718 (1881); *Richardson v. Marshall County*, 100 Tenn. 346, 45 S. W. 440 (1898); *Union Bank v. Oxford & C. L. R. R.*, 143 Fed. 193 (C. C. A. 4th, 1906) (relying on *Otis v. Cullum*); *Sutro v. Rhodes*, 92 Cal. 117, 28 Pac. 98 (1891) (county bonds invalid "because issued without authority;" also relied on *Otis v. Cullum*).

⁵⁶ 163 U. S. 385, 16 Sup. Ct. 1148 (1896). In this case certain numbered state bonds of an issue which consolidated all state bonds were held by the state treasurer for educational purposes. Subsequently, the sum so represented was declared a perpetual loan to the state and these bonds ordered destroyed. Thereupon the state treasurer, instead of destroying the bonds, sold them. The defendant bought some of them on the market and sold them to the plaintiff, who sued to recover the amount paid. Held: judgment for the plaintiff.

The main question discussed was whether the implied warranty included any obligation other than that the instrument was not forged. The Court said: "the undoubted rule is that, in such a sale, the obligation of the vendor is not restricted to the mere question of forgery vel non, but depends upon whether he has delivered that which he contracted to sell, this rule being designated, in England, as a condition of the principal contract, as to the essence and substance of the thing agreed to be sold, and in this

Otis v. Cullum not clear. With reference to the passage from *Otis v. Cullum*, quoted above, the court said that this remark had been interpreted too narrowly. In making it, "the mind was directed to that form of non-existence which more commonly obtains and the expression is a mere illustration of the rule *de eo quod plerumque fit*." While the Court, in *Meyer v. Richards*, is thus perfectly clear that a vendor warrants against forms of invalidity other than that of forgery, the question as to where the line between various defenses is to be drawn is indefinite. That a vendor of public securities does not warrant against all defenses which the obligor may successfully assert appears from the statement of Mr. Justice White:

"If this were a case where a vendee claimed to recover back the price paid by him on a purchase of negotiable securities, which pass by delivery from hand, on the averment that after the sale it had developed that they were not valid . . . because the law under which they had been issued was constitutionally void or ultra vires, the claim of implied warranty of existence would be without merit. . . . [Both parties would be] necessarily equally chargeable with notice of want of power, and therefore would be presumed to have acted with reference to such knowledge. This is *Otis v. Cullum*. But it is not the case at bar, since it is here admitted that both parties, in entering into the contract of sale, contemplated valid securities, of which there were many outstanding, and those delivered were void, not because of want of power to enact the law under which they were issued, or because they were ultra vires for some other legal cause, but because they were stricken with nullity by a constitutional provision adopted after the act authorizing the issue of the securities and where nothing on the face of the bonds indicated that they were illegal. The distinction pointed out by the foregoing statement not only illustrates the correctness of the decision in *Otis v. Cullum*, but also demonstrates the error of attempting to extend it to the state of facts presented in the case under consideration."⁵⁷

Meyer v. Richards is similar in its facts and holding to *Young v. Cole*, a case often relied upon. In this case a vendor of Guatemala bonds, invalid because not stamped within a designated time by a government agent, a fact unknown to both parties, was held liable by his vendee in an action for money had and received for the consideration paid therefor.⁵⁸ There

country being generally termed an implied warranty of identity of the thing sold." 163 U. S. at 405, 16 Sup. Ct. at 1155.

⁵⁷ 163 U. S. at 414, 16 Sup. Ct. at 1158.

⁵⁸ Tindal, J., said: "the consideration . . . failed as completely as if the Defendant had contracted to sell foreign gold coin and had handed over counters instead. It is not a question of warranty; but whether the Defendant has not delivered something which, though resembling the article contracted to be sold, is of no value." 3 Bing. N. C. at 730. Bosanquet, J., spoke of it as "worthless paper" and Coltman, J., said they "were not

are a number of authorities which either adopt the distinction drawn in *Meyer v. Richards* or are possibly contra to *Otis v. Cullum*.⁵⁹

It appears, therefore, that a vendor of public securities, at

Guatemala bonds." The two lines of reasoning in this type of case are here illustrated.

⁵⁹ *Keller v. Hicks*, 22 Cal. 457 (1863), transferor of illegally issued county warrants liable to his vendee. But in *Sutro v. Rhodes*, *supra* note 55, the vendors of county bonds, invalid because in excess of statutory authority, were held not liable, the court relying on *Otis v. Cullum*. *Rogers v. Walsh*, 12 Neb. 28, 10 N. W. 467 (1881), holding a vendor of "warrants issued by the commissioners of York county without authority of law," there being at the time "valid county warrants in the market," liable to his vendee. The court held that this case was not similar to *Lambert v. Heath*, *supra* note 55, or *Otis v. Cullum*, but was governed by *Young v. Cole*. Same holding after trial, 15 Neb. 309, 18 N. W. 135 (1884). *McCay v. Barber & Son*, 37 Ga. 423 (1867); *Tompkins v. Little Rock*, 15 Fed. 6 (C. C. E. D. Ark. 1882), holding a railroad company liable to its vendees for the sale of state bonds unconstitutionally issued and delivered as gifts by the state to the railroad. The court relied on *Young v. Cole* and *Jones v. Ryde*, and distinguished *Lambert v. Heath*. *Puch v. Moore, Hyams & Co.*, 44 La. Ann. 209, 10 So. 710 (1892); *Herwig v. Richardson & May*, 44 La. Ann. 703, 11 So. 135 (1892), Louisiana cases dealing with the same bond issue as that involved in *Meyer v. Richards*. *Furgerson v. Staples*, 32 Me. 159, 19 Atl. 158 (1889), sale of void town orders; the vendee recovered.

In *Bank of Commerce v. Ruffin*, 190 Mo. App. 124, 175 S. W. 303 (1915), an instrument, purporting to evidence a lien for taxes but void because the construction work, a sidewalk, was not located according to the city ordinance, was assigned by the contractor. Held: that the assignor, although he had no knowledge of the invalidity, was liable to his assignee. The court disapproved *Littauer v. Goldman*, *supra* note 54, and approved the criticism of this case in *Meyer v. Richards*. The court distinguished *Otis v. Cullum*, on the ground that "there is no implied warranty in cases of sales of government securities," because in such case "the defect rendering the bonds void is not latent but patent, because it appears on the records of the governmental body." Accord: *Miners' Bank v. Burrell*, 164 Mo. App. 690, 147 S. W. 1110 (1912) (invalid tax bills).

Hart v. Wyndmere, 21 N. D. 383, 131 N. W. 271 (1911) (vendor of invalid village warrants liable); *Giblin v. North Wisconsin Lbr. Co.*, 131 Wis. 261, 111 N. W. 499 (1907) (vendor of illegally issued county warrants liable). In *Wood v. Sheldon*, 42 N. J. L. 421 (1880), a vendor of a non-negotiable stock certificate, referred to as a "scrip dividend," was held liable by his vendee to refund the consideration paid. In another case this issue had been decreed to be "illegal and fraudulent." Both parties were ignorant of the invalidity at the time of sale. The court said: "The plaintiff did not bargain for the certificate, but for the money of which the certificate purported to be evidence of title. . . If a person sells a bond . . . the legal incidents of the transaction are the same as if the article sold had been a horse . . . The defendants, by the mere act of selling impliedly held out that the title to this money was in them. . . The ill-founded belief of the defendants, that they were possessed of a good title, is an ingredient of the case of no value for the ground of recovery is not deceit, but warranty." 42 N. J. L. at 423. The court relied on *Young v. Cole* and *Gompertz v. Bartlett*.

least under the rule of the Supreme Court of the United States, will be liable if the facts fall within the limits of the rule in *Meyer v. Richards* and will not be liable if they fall within the decision of *Otis v. Cullum*. But where are these limits? No case has been found, since *Meyer v. Richards*, where both have been referred to. And the cases mentioned in the notes, some holding the vendor liable and others holding him not liable, do not shed much light on the question. If *Otis v. Cullum* covers no case other than that of a bond issue put out under unconstitutional legislation, this test would be fairly definite, but not entirely so. How far back would this narrow interpretation be carried? If the statute under which the bonds are issued is a general statute and constitutional but the statute under which the government body was organized is unconstitutional, or the statute under which the officers, who put out the bonds, were elected is unconstitutional, does *Otis v. Cullum* apply? When is a statute unconstitutional within the meaning of *Otis v. Cullum*? But this is not the only uncertainty in the rule in *Otis v. Cullum*. It is not even to be limited to cases involving unconstitutional legislation, for Mr. Justice White in the passage above quoted from *Meyer v. Richards* said that *Otis v. Cullum* applied also when the bond issue was "ultra vires for some other legal cause." If this statement represents law and not dictum, *Otis v. Cullum* is by far the wider rule and *Meyer v. Richards* may be confined to cases where bonds in circulation were once enforceable and became unenforceable by subsequently enacted constitutional legislation. It is extremely unlikely, however, that the *Meyer v. Richards* rule would be so narrowly construed as to be held not to apply to sets of facts other than those where invalidity arises from subsequently enacted legislation.

It may be that the distinction lies along another line. In *Otis v. Cullum* all the facts which produced unenforceability were a matter of public record and therefore within the possible possession of every one; but not so in *Meyer v. Richards*. If a buyer looked them up he would know that the issue was invalid, assuming of course the requisite capacity for prophesying that the courts would hold the statute unconstitutional. This risk is heavy. It is also practically impossible for a buyer to gather together all the facts necessary for a judgment as to the validity of a particular bond issue. To deprive the vendee of a right against the vendor because the vendee is supposed to know of the defense is a pure fiction. The fiction, however, may conceal real reasons. Public officers who put out the issue, in many cases—perhaps most—would not be liable to purchasers. It can be argued that sellers of the bonds should be in the same position. It could be urged also that a rule which put liability on sellers of government and municipal bonds would hamper

distribution. Discount rates, on account of the risk, might be higher. On the whole it may reasonably be felt that the public, in whose interests the money is thus obtained, will be better off if the risk of invalidity is borne by the purchasers. The rule of the two cases would then be that, where all the facts necessary to determine validity or invalidity of the particular instrument offered for sale are of public record, a seller will not warrant enforceability; but where they are not all available, as in *Meyer v. Richards*, a seller will be liable. The rule in *Otis v. Cullum*, and the cases which follow it, is not necessarily out of harmony with the idea that a vendor of commercial paper warrants against all real defenses, for in such cases it may be considered that the buyer could have learned of the defense. Knowledge by the vendee, of any defense, can be treated as a destruction of the implied warranty with respect thereto.

The above cases deal with bonds issued by some governmental authority. To what extent does the rule apply to the sale of private securities? In *Lambert v. Heath*,⁶⁰ there was a sale of "scrip certificates of shares in the Kentish Coast Railway Company." There was evidence that the scrip had been "issued without authority." In an action by the vendee against the vendor, the court left it to the jury "to say whether the scrip bought by the defendant for the plaintiff was genuine scrip of the Kentish Coast Railway Company or not." The jury found that it was not and returned a verdict for the plaintiff. A new trial was ordered. The entire opinion of Alderson, B., was as follows:

"The question is simply this—was what the parties bought in the market 'Kentish Coast Railway Scrip'? It appears that it was signed by the secretary of the company; and if this was the only Kentish Coast Railway scrip in the market, as appears to have been the case, and one person chooses to sell and another to buy that, then the latter has got all that he contracted to buy. That was the question for the jury, but it was not left to them: the rule must therefore be absolute for a new trial."

The inference is that the defendant was not liable because "he got all that he contracted to buy"—whatever this may mean—just as in *Young v. Cole* the vendor of unstamped Guatemala bonds was held liable because the buyer did not get all that he contracted to buy. This reminds one of Lord Abinger's discovery of the difference between beans and peas.⁶¹ Doubtless there is a difference, but it is of no more importance, in this connection, than is the difference between green beans and wax beans, or beans of the same specie that will germinate and those that will not, or between musty beans and fresh beans. And

⁶⁰ *Supra* note 55.

⁶¹ *Chanter v. Hopkins*, 4 M. & W. 399 (1838).

the same with bonds. If the parties think about it at all they think of the purchase and sale of legal obligations. The buyer takes the risk of insolvency of the obligor—probably consciously so. And certain risks, theoretically ascertainable by inspection of public records, as well as the risk of ignorance of a good deal of the law of the land, may also be put upon him—but hardly for the reason stated in *Lambert v. Heath*. In fact the English court itself, in *Hall v. Conder*,⁶² shifts to the much more reasonable basis of classification by holding that the vendor of a patent did not warrant that it was indefeasible because each party had an equal means of ascertaining the facts, and that for this reason the case did not fall within *Young v. Cole* and *Gompertz v. Bartlett*. There is nothing in the English cases of *Young v. Cole* or *Lambert v. Heath*, or the American cases of *Otis v. Cullum* and *Meyer v. Richards*, confining the rule, whatever it is, which in certain cases puts the risk of invalidity on the buyer, to transactions involving government securities. The same is true of the cases cited in the notes,⁶³ with the exception of the Missouri case,⁶⁴ in which it was said that “there is no such implied warranty in cases of sales of government securities.”⁶⁵

Accordingly there are cases, involving the sale of private securities, where the risk of invalidity is put on the buyer, although the reasons therefor are not as strong, perhaps, as in the sale of public securities. But few cases on the point have been found. In a California case⁶⁶ concerning the sale of bonds of a water company where the vendee claimed that the bonds were invalid because the provisions of the statute were not complied with, the court refused to go into this question on the authority of *Sutro v. Rhodes*,⁶⁷ a case involving the sale of invalid county bonds which, in turn, relied on *Otis v. Cullum*. The court, upon the principle of that case, said: “we must hold that the defendant [buyer] herein cannot resist the payment of the note [given in payment] sued on. He got from the plaintiff exactly what he intended to buy and did buy, viz., one of the bonds of the corporation.” The court then shifted to the preferable line of argument by adding: “He had the same opportunity as the plaintiff to ascertain the steps that had been taken by the corporation in the issuance of the bonds, and whether he made such examination or not he bought subject to

⁶² 2 C. B. (N. S.) 22, 53 (1862).

⁶³ *Supra* notes 55 and 59.

⁶⁴ *Bank of Commerce v. Ruffin*, *supra* note 59.

⁶⁵ 190 Mo. App. at 136, 175 S. W. at 307.

⁶⁶ *Harvey v. Dale*, 96 Cal. 160, 31 Pac. 14 (1892). See also *Coast Realty Co. v. St. Co.*, 118 Miss. 690, 79 So. 848 (1918).

⁶⁷ *Supra* notes 55 and 59.

the rule of caveat emptor and assumed all the risk of its invalidity."⁶⁸ Other cases are to the same effect.⁶⁹

With respect to the sale of government and private securities Section 65(3) of the Negotiable Instruments Law imposes the warranty "that all prior parties had capacity to contract." The last paragraph of Section 65(4) then prescribes an exception by adding: "The provisions of subdivision three of this section do not apply to persons negotiating public or corporation securities, other than bills and notes." In all cases, therefore, which fall within this language, there is no implied warranty of capacity. Such cases will then be controlled by Section 65(1), (2) and (4); (1) dealing with genuineness, (2) with title and (4) with the warranty against invalidity when the transferor has knowledge thereof. Subsection (4) is discussed in the next section. It becomes important therefore to know just what cases are withdrawn from Section 65(3). It is believed that this Section, worded as broadly as it is, rules out all such cases as were discussed in the last section. The result is that a court can no longer hold, as was done in *Meyer v. Richards*, that under the facts of that case there was a warranty of validity although the transferor had no knowledge thereof, because, after the Act, knowledge of invalidity is by Section 65 (4) essential to the vendor's liability.

The term "securities" might well have been defined in the Act. Moreover, there is no very strong reason why the exception should apply only to the securities of corporations as distinguished from other forms of business organization.

Knowledge of Invalidity

In none of the long line of cases noted in the last section was it held that the right of a vendee to rescind or sue for breach of warranty was conditioned upon proof that the defendant knew of the defense of the prior party which constituted the breach. Yet in *Littauer v. Goldman*⁷⁰ the New York court held

⁶⁸ 96 Cal. at 161, 31 Pac. at 15.

⁶⁹ *Marshall v. Keach*, 227 Ill. 35, 81 N. E. 29 (1907), holding that in the sale of certificates of stock in a private corporation there is no implied warranty that the stock was issued by a de jure corporation. Accord: *Harter v. Eltzroth*, 111 Ind. 159, 12 N. E. 129 (1887). Both courts relied on *Otis v. Cullum*.

If the seller is guilty of fraud, there could then, of course, be rescission for this reason independent of the above rule. *Currier v. Poor*, 155 N. Y. 344, 49 N. E. 937 (1898).

⁷⁰ *Supra* note 54. In many of the earlier cases in New York and elsewhere, where usury was the defense, the defendant did have knowledge of the defense. *Delaware Bank v. Jarvis*, 20 N. Y. 226 (1859); *Ross v. Terry*, 63 N. Y. 613 (1875); cf. *Smith v. Corege*, 53 Ark. 295, 14 S. W. 93 (1890); *Drennan v. Bunn*, 124 Ill. 175, 16 N. E. 100 (1888); *Challis*

that knowledge was necessary, at least where the maker's defense was usury. In addition to the cases to the contrary noted in the preceding sections, the cases collected in the note hold that knowledge is not necessary.⁷¹ Likewise in *Wood v. Sheldon*,⁷² the New Jersey court said that *Littauer v. Goldman* was "admittedly supported by no precedent," and held that a vendor of illegally issued scrip was liable although he had no knowledge of the invalidity. The Supreme Court of the United States also held otherwise in *Meyer v. Richards*,⁷³ referring to *Littauer v. Goldman* as "an exceptional case," and concurring in the criticism of it by the New Jersey court. A Missouri appellate court also approved these criticisms.⁷⁴ And New York itself has discredited the doctrine, for in *McClure v. Central Trust Co.*,⁷⁵ the court said:

"In view of the latest case in this court upon the subject of implied warranty, *Littauer v. Goldman* may properly be limited to commercial paper, as it is the policy of the law to throw special safeguards around the transfer of such property. Although cited in the case of *Flandrow v. Hammond*,⁷⁶ it was not allowed to control the decision."⁷⁷

Warranty of Liability of Prior Parties

It appears then that at common law a transferor by delivery and an indorser without recourse warranted against all real

v. McCrum, 22 Kan. 121 (1879); Hannum v. Richardson, 48 Vt. 508 (1875). *Littauer v. Goldman* misinterpreted these cases by assuming that such knowledge was a requisite of liability.

⁷¹ *Ellis v. Grooms*, 1 Stew. 47 (Ala. 1827); *McCay v. Barber & Son*, 37 Ga. 423 (1867); *Frazier v. D'Inwilliers*, 2 Pa. 200 (1845) (indorser without recourse held liable on note where marks of payment erased); *Mays v. Collision*, 6 Leigh 230 (Va. 1835) (accord); *Boyd v. Anderson*, 1 Overt. 438 (Tenn. 1809) (assignor of invalid land warrants liable to assignee); *Lawton v. Howe*, 114 Wis. 241 (1861) (same). Payments in money of the Confederacy were usually held to discharge the debt. *Rogers v. Bass*, 46 Tex. 505 (1877); *Mercer v. Wiggins*, 74 N. C. 48 (1876); *Rockhold v. Blevins*, 6 Baxt. 115 (Tenn. 1873); *Howard College v. Turner*, 71 Ala. 429 (1882). But cf. *Cooksey v. McCrery*, 27 Ark. 303 (1871). But where payment was made within the federal lines the transfer was held no payment. *Ewing v. Litsey*, 70 Ky. 496 (1870). Transfers after the war were not payments, *Cundiff v. Herron*, 33 Tex. 622 (1870), the question being whether the instrument was regarded as legal at the time and place of transfer.

⁷² *Supra* note 59.

⁷³ *Supra* note 56.

⁷⁴ *Bank of Commerce v. Ruffin*, *supra* note 59.

⁷⁵ 165 N. Y. 108, 58 N. E. 777 (1900).

⁷⁶ 148 N. Y. 129, 42 N. E. 511 (1895).

⁷⁷ 165 N. Y. at 126, 58 N. E. at 782. An express warrantor against usury is held liable although he does not know of the usury. *Buehler v. Pierce*, 175 N. Y. 264, 67 N. E. 573 (1903).

defenses of all prior parties. *Littauer v. Goldman* alone was to the contrary in requiring knowledge of the defense when the defense was that of illegality. But these warranties, here treated as separate, were really but manifestations of a single warranty, the warranty that all prior parties were liable, or, as put in many cases, the transferor warrants that the instrument is valid and subsisting.

As expressed by the Indiana court:

"There is a vast difference between the liability of an indorser and that of a mere assignor. The former warrants the liability and the ability of the payor to pay, while the latter simply warrants the genuineness of the obligation, and that it is unpaid."⁷⁸

Or, as put by the Kentucky court:

"The appellant [assignor] when he assigned the note undertook and agreed with the assignee that the latter could enforce it against the parties whose names were signed to it, or at least that a legal obligation existed upon the part of the obligors to pay it."⁷⁹

There are other authorities which fuse the specific warranties into the single idea of enforceability.⁸⁰ Accordingly, if there are no defenses of prior parties as against the holder, that is, if the transferee may or has obtained a judgment against them, there is no breach of warranty by the transferor.⁸¹ Similarly, the indorser without recourse warrants the existence of all facts necessary to a recovery by his vendee against all prior parties.⁸²

⁷⁸ *Earnest v. Barrett*, 6 Ind. App. 371, 373, 33 N. E. 635, 636 (1892).

⁷⁹ *Hurst v. Chambers*, 75 Ky. 155, 158 (1876).

⁸⁰ *Ellis v. Grooms*, *supra* note 71; *Michel v. Valentine*, 10 Rob. 404 (La. 1845); *Eaton v. Mellus*, 7 Gray 566 (Mass. 1856); *Carroll v. Nodine*, 41 Ore. 412, 69 Pac. 51 (1902).

"I do not entertain any doubt that the defendant [transferor by delivery] impliedly warranted against any legal defense to an action to be brought on the note." *Delaware Bank v. Jarvis*, *supra* note 70, at 231. ". . . the assignor impliedly warrants that [the note] is valid, and that the maker is liable upon it." *Daskam v. Ullman*, 74 Wis. 474, 476, 43 N. W. 321 (1889). The vendor warrants against the maker's right of set-off. *Jones v. Yeargin*, 12 N. C. 420 (1828) (transferor by delivery); *Ticonic Bank v. Smiley*, 27 Me. 225 (1847) (qualified indorser).

⁸¹ *Clark v. Sallaska*, 70 Okla. 293, 174 Pac. 505 (1918) (transferee by delivery who had obtained judgment against maker of note held not entitled to judgment against transferor).

⁸² The indorser without recourse warrants the instrument "valid against all signers," *Hankerson v. Emery*, 37 Me. 16 (1853); "that it is not discharged," *Mays v. Collison*, 6 Leigh 230 (Va. 1835); that a mortgage which secures the note so indorsed, is a valid lien on the whole of the land described, *Templeman v. Hamilton & Co.*, 37 La. Ann. 754 (1885); *Wait v. Williams*, 107 S. C. 32, 91 S. E. 969 (1916); *Palmer v. Courtney*, 32 Neb. 773, 49 N. W. 754 (1891); *Freeman v. Guyer*, 13 Ill. 652 (1852).

"By selling the note indorsed 'without recourse' to the plaintiff the de-

Are specific warranties generalized into a single one under the Negotiable Instruments Law? The framers thereof would have done well to have dealt more specifically with the entire field of real defenses. What we have is a scattered and partial treatment. They did not deal with illegality as a real defense. No section touches on the fraud in inception cases, nor those involving negligent execution. Incapacity is omitted, except by the barest reference in Section 22. This being the situation one would hardly expect the framers of the Act to think in terms of the entire field of real defenses in defining the warranties of the vendor. Yet they did approach it in the clause which imposes a warranty that "the instrument is in all respects what it purports to be." If the specific warranty of genuineness in Section 65(1) and of capacity in Section 65(3), be regarded as illustrations of this wider warranty, then it is believed the warranty that the instrument "is in all respects what it purports to be" should include all other real defenses, except as the first part of Section 65(4) operates as a limitation thereon. This latter provision, in making the warranty of validity depend on knowledge of the vendor, changed the law. It is unfortunate that the exceptional doctrine of *Littauer v. Goldman* should have thus found lodgment in the Statute. It is out of harmony with the general ideas as to the nature of warranty in sales of chattels and with the present tendencies in this field of the law.

Warranty Against Personal Defenses

Is there also a warranty against personal defenses? The cases noted, in holding and asserting that there is a warranty "that the instrument is not paid," that "prior parties have no legal defense thereto," that "prior parties are liable," that the maker "has no right of set-off," and that the instrument as against prior parties "is valid and subsisting," all tend to show that there is such a warranty. At least, they tend to show that there is such warranty when the personal defense would be available as against the vendee.

This inference is further borne out by the cases involving implied warranties in the assignment of non-negotiable choses in action. That such cases may properly be considered pertinent to questions arising from the sale of negotiable paper appears

endant represented that the same was a valid subsisting obligation. The proof established that it had been satisfied . . . it seems clear that plaintiff is entitled to recover the amount so paid." *Roley v. Walker*, 161 Ill. App. 646 (1911). Accord: *Frazer v. D'Invilliers*, *supra* note 71. "In purchasing the notes [indorsed without recourse] plaintiffs took their chances on the financial responsibility of the makers and indorsers but had a right to rely upon the representation that they were legally bound." *Hoover v. Pursel*, 67 Pa. Sup. Ct. 130 (1917).

in many decisions, and in fact the cases are often used interchangeably. Indeed questions as to implied warranties in the sale of chattels, non-negotiable choses in action and negotiable instruments, are but different aspects of the same fundamental legal policy. On this unity of purpose and of means of accomplishment, the New York Court of Appeals once declared:

"The principle which governs sales of tangible chattels applies with equal force to sales of incorporeal chattels, such as a promissory note without indorsement, or a share of stock, where the thing actually sold is the right evidenced by a piece of paper with a particular name, though the form of the sale is of the paper itself."⁸³

From the cases collected in the note,⁸⁴ it appears that an assignor of a non-negotiable chose in action warrants that he has

⁸³ McClure v. Central Trust Co., *supra* note 75, at 123, 58 N. E. at 781. Cf. WILLISTON, *op. cit. supra* note 33, at § 445: "Indeed there seems no reason to distinguish the warranties to be implied on the assignment of a non-negotiable chose in action from those implied when negotiable instruments are sold without indorsement or with only a qualified indorsement."

⁸⁴ The assignee of a bond has "an indefeasible right to demand what the bond calls for." *Emmerson v. Claywell*, 53 Ky. 15 (1853). The assignee of a claim not due to the assignor because of the non-fulfillment of a condition precedent—the birth of a colt—may recover from the assignor. *Gilchrist v. Hilliard*, 53 Vt. 592 (1880). The assignor without recourse of a bond for \$1300, on which was due only \$666.10, is liable to the assignee. *Trustees of Broadus Institute v. Siers*, 68 W. Va. 125, 69 S. E. 468 (1910).

"Every holder of an obligation, who assigns it to another . . . impliedly at least, thereby engages that it is genuine and binding upon the obligor." *Flynn v. Allen*, 57 Pa. 482, 485 (1868) (plaintiff failed to recover on bond issued by school district to defendant who had not rendered the service for which bond was given in advance).

The assignor of a judgment warrants that the amount called for thereby is due and unpaid. *Furniss v. Ferguson*, 15 N. Y. 437 (1857); *Findley v. Smith*, 42 W. Va. 299, 26 S. E. 370 (1896); *Thompson v. First State Bank*, 102 Ga. 696, 29 S. E. 610 (1897) (assignor warrants that the judgment assigned "is unpaid and a valid subsisting debt"). And see WILLISTON, *op. cit. supra* note 33, at § 445. The assignor without recourse of a judgment which was reversed subsequent to the assignment is liable to the assignee because such an assignor "warrants that it is what it purports to be, that it is unpaid and constitutes a legal obligation against the defendant therein." *Emerson v. Knapp*, 75 Mo. App. 92 (1898). Accord: *Cooper v. Sagert*, 111 Ore. 27, 223 Pac. 943 (1924). But an assignor of a judgment entered by confession does not impliedly warrant that the judgment cannot be vacated. *Hinkley v. Champaign National Bank*, 216 Ill. 559, 564, 75 N. E. 210, 212 (1905): "The implied warranty is that it is a genuine judgment, that in due form of law a judgment was entered, that the court had jurisdiction to enter it and that it has not been paid, released or otherwise nullified."

The assignor of a bond for title does not warrant that the obligor will perform. *Hazer v. Yost*, 54 Ark. 485, 16 S. W. 372 (1891) (assignor held not liable to assignee for expenses incurred in obtaining conveyance).

performed all conditions precedent to his right to demand performance by the obligor, that the claim is owing and unpaid, and that it is a valid subsisting debt, the legal obligation of the obligor. While all defenses to an action on a simple contract are not here illustrated, there is a sufficient number and variety to support the wider statement, also appearing in the cases, that the assignor warrants against the existence of all equities of defenses and of ownership which the obligor or a third party may have against the assignor. Thus the assignee, in taking subject to equities and defenses, obtains his reimbursement from his assignor.

In this connection a digression may be made to note that an assignment of a non-negotiable instrument is sometimes made "without recourse." This qualification has an obvious general purpose when used in connection with the transfer of negotiable paper. What effect should be given to it when used on non-negotiable paper? It has been held that such an assignment has the same effect as is given to the indorsement without recourse of negotiable paper, and that, apparently, this meaning is not subject to variation by agreement of the parties.⁸⁵ According to Williston, "the more reasonable construction of these words is that the assignor is only seeking to make certain what the law would indeed, in any event, imply from a mere assignment, that he is not responsible for the solvency of the debtor."⁸⁶ In some cases the assignment without recourse of non-negotiable choses in action means the same as does the indorsement without recourse of negotiable paper, but presumptively only. The meaning may be controlled by the parties.⁸⁷ In other states, there is no presumption as to the meaning of the words, but parol evidence is admissible to show in what sense the parties used them and this meaning when found will control.⁸⁸ At the

⁸⁵ *Houston v. McNeer*, 40 W. Va. 365, 22 S. E. 80 (1895); *Trustees of Broadus Institute v. Siers*, *supra* note 84; *Crawford v. M'Donald*, 2 H. & M. 189 (Va. 1803) (assignment of vendee's interest in a contract to sell land without recourse shows that the assignee "was to run all hazards as to the title to the lands").

⁸⁶ WILLISTON, *op. cit. supra* note 33, at § 445.

⁸⁷ "Those words ['without recourse'] have no precise legal signification outside the law of commercial paper, and unless it is manifest that they were intended to express a different meaning they must be given their ordinary effect." *Kail v. Bell*, 88 Kan. 666, 668, 129 Pac. 1135, 1136 (1913).

⁸⁸ *Binswanger v. Hewitt*, 79 Misc. 425, 140 N. Y. Supp. 143 (1913), an action by an assignee against the assignor of a judgment for breach of the warranty that the judgment was owing and unpaid. It was argued on the one hand, that inasmuch as the chose assigned was not negotiable, the words "without recourse" were a mere nullity, and on the other that they had the effect of destroying the implied warranty that the judgment was still owing. The court replied: "We cannot adopt either view. . . . [We] hold that this phrase used in an assignment of a chose in action,

other extreme, it has been held that such an assignment destroys, at least presumptively, the implied warranties which otherwise would have accompanied it.⁸⁹

Returning to the main point, it would seem, therefore, that at common law there was a warranty against personal defenses, at least as against a holder who took subject to such personal defense. If the payee acquires the note from the maker by fraud or under other circumstances which give the maker a defense against the payee, and the payee transfers by delivery or indorses without recourse to A, after maturity, is there any reason to doubt the liability of the payee to A? Of course, if A is not a holder in due course because he knows of the defense, or is a donee, these facts would destroy the warranty by implication.

If the vendor warrants against personal defenses which happen to be available against the vendee, does the vendor warrant against them if his vendee is a holder in due course? Does the vendor warrant against personal defenses irrespective of their availability against the vendee, or does he merely warrant the existence of such facts as will enable his vendee to get a judgment against all prior parties?

There is but little authority here. It has been held in a Michigan case that the mere fact that the vendee was a holder in due course, and could, therefore, hold the maker liable free from his personal defense of illegality, did not prevent him from

having no defined legal meaning, must be given such meaning as the parties themselves intended to give it which must be determined as a question of fact taking into consideration all the surrounding circumstances, giving due weight to the parol evidence that may be adduced having reference thereto." 79 Misc. at 430, 140 N. Y. Supp. at 145. Because neither party adopted this theory at the trial, the judgment for the plaintiff was reversed. Accord: *Charnley v. Dulles*, 64 Pa. 353 (1845), holding that the liability of an indorser "without recourse" of a non-negotiable certificate of deposit, on which the payee's indorsement was forged, was not necessarily that of the liability of an indorser without recourse of negotiable paper.

⁸⁹ "The words *sans recours* (without recourse), so far as we can ascertain, have no exact legal significance, except when they are employed by an indorser to limit his liability upon a negotiable instrument." After stating that an assignment of a judgment carried certain warranties and also the beneficial interests of the judgment creditor, the court concluded: "the only legal effect produced by the use of [the words 'without recourse'] is to relieve the assignor from liability to the assignee on account of the breach of either of the several implied warranties." *Thompson v. First State Bank*, *supra* note 84, at 698, 29 S. E. at 610. The case is referred to in *Camp Mfg. Co. v. Durham Fertilizer Co.*, 150 N. C. 417, 64 S. E. 188 (1909). This rule, apparently, was applied in *Scofield v. Moore*, 31 Iowa 241 (1871), where the assignor without recourse of a judgment was held relieved from his warranty that it had not been paid.

recovering from his vendor.⁹⁰ The vendor, in this case, however, knew of the defense, and it is possible that he expressly warranted the enforceability of the note to his vendee, the plaintiff. The possible existence of the express warranty here would seem to be of slight importance, however, because there was as much doubt as to its content as there is with respect to the content of the corresponding implied warranty. The element of knowledge of the defense by the vendor was treated by the court as the main reason for his liability to the vendee. This would seem to be a just result. It puts the loss on the party at fault with the minimum of time and expense. Otherwise, the vendee would recover from the maker, who in turn would sue the fraudulent payee.

A California case, however, is *contra*, for here the vendee was not allowed to recover from the vendor, payee, who had received payments before maturity from the maker, because the vendee was a holder in due course. The court said:

" . . . being . . . a bona fide holder . . . for value and without notice of the payments made . . . he cannot suffer loss by reason of such payments. In order to support a recovery . . . there must not only have been a breach of the agreement on his part but some loss or damage resulting to the promisee."⁹¹

This result is open to the objection pointed out by the Michigan court.

In each of the above cases the vendor not only had knowledge

⁹⁰ *Evans v. Stuhrberg*, 78 Mich. 145, 149, 43 N. W. 1046, 1047 (1889). The court stated its reasons as follows: "If this note was made good in the hands of the plaintiff because she was an innocent purchaser, she was made such innocent purchaser by the fraud of the defendant, who concealed from her not only the original consideration of the note, but warranted it to be a good note when he knew it was not a valid one, except as it might be made so by the success of his description and falsehood. The law in such a case will not force the plaintiff to collect the note against the maker, though she may be able to do so, nor allow the defendant to reap a profit from his own fraud, as well as to galvanize by such fraud a dead note into life. . . . The commercial law in favor of innocent purchasers . . . was not intended as a shield to those fraudulently putting in circulation illegal or void notes."

⁹¹ *Swall v. Clarke*, 51 Cal. 227, 229 (1876). In this case the maker paid the payee a part of the note before maturity. The payee transferred without indorsement to A and covenanted that a specified sum was due thereon. This was not true for it failed to take account of these payments. A transferred to B and expressly assigned this covenant. B sued the payee. Held: he could not recover. The express covenant here, it is believed, would be no wider than the implied one. There having been an express assignment of this covenant, the only difference is that the plaintiff is now enabled to sue the prior vendor with whom his vendor dealt, whereas had there been no assignment of the covenant the plaintiff could have sued only his vendor.

of the defense but participated in and profited by the facts which gave rise to it. What should be the result (1) when the vendor merely had knowledge of the defense but did not participate therein, and (2) when he had no knowledge? Under the California decision, where the vendor is held not liable when he had knowledge and did participate in the wrong, it is clear that he would not be liable in either of the two cases mentioned. Under the Michigan case, he might or might not be liable. Since the court stressed the idea of the vendor "reaping a profit from his own fraud" the implication is that if he had no knowledge of the defense he would not be liable, and, possibly, that the same result would be reached where he had knowledge of the defense but had not participated therein.

The problem is puzzling. In favor of liability of the vendor it can be urged that he does warrant against personal defenses to holders against whom they are available. Consistency would say there was no reason to free him from that liability merely because of the fortuitous event that his vendee can recover free from it. And again, knowledge of the defect in a chattel or defense to a negotiable instrument, *Littauer v. Goldman* aside, is not a requisite to implied warranty. Liability therefore should not turn on its existence or nonexistence.

On the other hand, it can be urged that the central idea of warranty is that it is an assumption of risk by the seller for actual or potential damage to the buyer. If this damage is absent, there should be no warranty. The most that a buyer of a negotiable instrument has reason to expect is the legal obligation of every prior party. If he can obtain a judgment against them he gets all that he relied upon the seller to give him. It could also be urged that, in the case of a remote vendor, the policy of allowing the vendee to hold his vendor liable might generate more law suits than would arise if the vendee held the prior party liable directly, that party then suing his transferee for the wrong.

Does the vendor warrant against personal defenses under the Negotiable Instruments Law? To a vendee against whom the defense is available it might seem so for Section 65(1) imposes a warranty that the "instrument is in all respects what it purports to be." If this means the same as "valid and subsisting," or the same as the expression, "the enforceable legal obligation of prior parties," phrases used repeatedly in the common law cases, the result would be the same under the Negotiable Instruments Law. This would more clearly be so were it not for Section 65(4). One could argue under that Section that all personal defenses concerned "validity" and therefore the warranty against them depended upon knowledge of the vendor. The Section rather definitely controls the defense of illegality, even

when real. It would surely cover defenses of illegality when personal. It is only a short step from there to say that all other personal defenses concern validity and are therefore withdrawn from the operation of Section 65(1) and are controlled by the more detailed Section 65(4). It is believed that this is the more likely result to be reached, flowing, of course, from the codification of *Littauer v. Goldman*. Such result presents the anomaly of the assignor of a non-negotiable chose in action being under a heavier responsibility to his assignee than is the vendor of a negotiable instrument.

Warranty of Liability of Secondary Parties

Thus far, for convenience only, discussion has been only with respect to warranties against defenses of the maker, drawer and acceptor. A vendee may find it necessary to hold liable a prior unqualified indorser. All that has been said heretofore concerning defenses of the maker, drawer and acceptor apply with equal force to the unqualified indorser. If the indorser's indorsement is forged, the instrument is not genuine, as to him. If he has indorsed with qualification, and the qualifying words are wrongfully erased, there has been a material alteration. Again the instrument is not genuine, as to him. So also if the indorser is under contractual disability. And so on through all the defenses. In short, whenever a vendee can hold his vendor liable because the maker, drawer or acceptor possessed some defense, the vendor can be held liable because a prior indorser had such defense. To the extent that a vendor warrants against defenses at all, he warrants against the defenses of all prior parties.⁹²

While the Negotiable Instruments Law is not as clear on this point as it should be, enough is there said, it is believed, to justify the same statement under its provisions. For example, Section 65(3) imposes the warranty that "all prior parties had capacity to contract." This very clearly includes indorsers as well as the maker, drawer and acceptor. It is inconceivable that one whose indorsement was forged could be held liable. Since there is a warranty against incapacity of indorsers, it must be that Section 65(1) applies with equal force to indorsers. A

⁹² *Lobdell v. Baker*, *supra* note 43. The court said: "When therefore, a man . . . puts into circulation a note, bearing the name of a blank indorser, with nothing to rebut the natural inference to be drawn from it, he by necessary implication affirms that the indorser is a person capable of indorsing." 3 Metc. at 471. An indorser without recourse warrants against defenses possessed by prior indorsers. *Hoover v. Pursel*, *supra* note 82. In this case the only solvent indorser had been released by the defendant's predecessor in title, a bank of which defendant was the receiver.

forged indorsement would present a case of a non-genuine instrument as regards this indorser, against which the Section imposes the warranty. So under the Statute, whenever a vendor warrants against defenses of the maker, drawer and acceptor, he will likewise warrant against these same defenses of an unqualified indorser.

Warranty Against Outstanding Equities of Ownership

Existence of defenses by prior parties is but one of the reasons for the failure of the transferee to collect. The transferee may fail to recover from prior parties because the transferor did not have title. In an early Pennsylvania case, where it was strongly argued that there should be no implied warranty of title, the court replied that there was as much reason for a warranty of title as there was for a warranty that the maker's name was not forged.⁹³ This argument, the court said, would force the transferee to pay for what was nothing more than "waste paper." "I also hold," concluded Yeates, J., "that if such bill or note purports to bear the signature of certain persons, who are responsible therefor, or through whom the buyer must necessarily derive his title, and these signatures are afterwards falsified by the fact, whereby injury or damage arise to the purchaser, the seller becomes answerable therefor."⁹⁴ Numerous cases support the rule that a vendor warrants that he has title. To put it otherwise, there is a warranty against forged indorsements of indorsees whose indorsement is essential to a transfer of title.⁹⁵

No cases have been found which raise the question whether there is a warranty against outstanding equities of ownership when the transferor had what might be called a voidable legal title, or the title of an express or constructive trustee. If the transferee is a holder in due course the equity is cut off, and the question as to whether there is a warranty would be precisely the same as that previously raised, *i.e.*, is there a war-

⁹³ *Richie v. Summers*, 3 Yeates 531 (Pa. 1830). Accord: *Summers v. Coates*, 14 Pa. 530 (1803) (indorser without recourse).

⁹⁴ 3 Yeates at 542.

⁹⁵ *Terry v. Bissell*, 26 Conn. 23 (1857), where the matter was considered at some length, analogies to the sale of chattels being employed. *Cluseau v. Wagner*, 126 La. 375, 52 So. 547 (1910); *Cabot Bank v. Morton*, 4 Gray 156 (Mass. 1855); *Whitney v. National Bank of Potsdam*, 45 N. Y. 303 (1871); *Dumont v. Williamson*, 18 Ohio St. 515 (1869) (indorser without recourse); *First National Bank of Mount Vernon v. First National Bank of Lincoln*, 68 Ohio St. 43, 67 N. E. 91 (1903); *Ledwich v. McKim*, 53 N. Y. 307 (1873); *Aldrich v. Jackson*, 5 R. I. 218 (1858) (transferor by delivery); *Strange v. Ellison*, 2 Bailey 385 (S. C. 1831); *Hall v. Latimer & Son*, 81 S. C. 90, 61 S. E. 1057 (1908) (indorser without recourse); *Allen v. Clark*, 49 Vt. 390 (1877).

ranty against personal defenses to a holder in due course? If the transferee is not a holder in due course because he has knowledge of the outstanding equity, there would be no warranty in any event because it would be deemed destroyed by implication. If he were a donee the result would be the same. If he were not a holder in due course because he took after maturity, it would have to be decided first whether he took free from the equity even though he was not a holder in due course. It is not proposed to retrace here the ground covered by Professor Chafee in his article on overdue paper.⁹⁰ Suffice it to say that under some facts the purchaser after maturity takes free from the outstanding equity and in others he does not. Where the transferee does take free we have the same question as that just mentioned. Where the transferee takes subject to the equity there should be a warranty on analogy to the cases which impose a warranty against personal defenses to a transferee who takes subject to them. In both cases he fails to collect, in the one case because of a superior equity of defense, in the other because of a superior equity of ownership. His rights should be the same in both cases. Against this solution it could be argued that, having taken after maturity, the transferee must be deemed to have notice of the equity, at least of its possibility, but Professor Chafee's argument to the contrary on this point seems stronger.

The Negotiable Instruments Law enacts in Section 65(2) that "every person negotiating an instrument by delivery or by a qualified indorsement warrants that he has a good title to it." This Section clearly codifies the common law rule, thus imposing a warranty against prior forged indorsements of indorsees whose indorsements were essential to a transfer of title.

Where the transferor had a voidable title or a trustee's title, the question whether there is a warranty against it should be solved the same as at common law. The nature of the problem when the transferee takes free from the equity has been stated. Where he takes subject to the equity there should be a warranty under the Act. Under Section 65(1) he warrants that the instrument is "in all respects what it purports to be." If this clause read that the vendor warranted "that the instrument was valid and subsisting" or that "the instrument is the enforceable legal obligation of the parties whose names appear thereon," there could be very little doubt but that there was such a warranty. But in the common law cases these three phrases were used with the same meaning. An instrument, therefore, purports to be an enforceable obligation. The warranty in Section 65(2) that the vendor "has a good title

⁹⁰ *Op. cit. supra* note 1.

to it," should mean a title good as against all parties. The transfer of a voidable title, therefore, would not be a compliance with the warranty. Section 65(4) perhaps contains an implication contrary. If all personal defenses and equities of ownership were regarded as having to do with "validity," then the requirement of this Section that the vendor have knowledge of the invalidity, would modify the above argument accordingly.

*Sale of the Instrument as Distinguished from Transfer
in Payment of Debts*

An instrument may be transferred in "payment" of an antecedent or contemporaneous debt. When so transferred it will usually be received in "payment." But the instrument may also be transferred by one who thinks of himself as a "seller," and received by one who conceives of himself as a "purchaser." Normally, one "sells" goods and receives negotiable instruments in "payment." One "buys" drafts and bonds, the transferor thinking of himself as a "seller." Sometimes one terminology will be adopted and sometimes another. Should the liability of a transferor in "payment" of his obligation be any different from that of a transferor who "sells"? If so what should be the test for determining whether an instrument is transferred in "payment" or transferred as a "sale"?

It has been held in some cases that there is a difference. The Massachusetts court took this position in *Ellis v. Wild*⁹⁷ in 1810. A transferor of goods, who had received in exchange a note of a third party without the indorsement of the transferor, could not collect from the maker because the note bore a forged indorsement. The court held that the transferor of the goods could not recover from the transferor of the note:

"If it was the original intent of the defendant to sell and of the plaintiff to buy, the notes, and to make payment in rum, the defendant has fulfilled his contract and the plaintiff cannot maintain this action. But if the plaintiff intended to sell the rum for money and the defendant intended to buy rum, and the payment by the notes was not a part of the original stipulation, but an accommodation to the defendant, then he has not paid for the rum, and the action is maintainable. Were we to decide on the intent from the words of the report, we must conclude the intent of the plaintiff to have been to deliver rum in payment for the notes; and therefore the verdict [for plaintiff] must be set aside."⁹⁸

Similarly, in *Harley v. Thornton*, the South Carolina court in 1833 held:

⁹⁷ 6 Mass. 321.

⁹⁸ *Ibid.* 322.

"If such note or bill be paid in satisfaction of a previous debt, or if it be paid in the ordinary course of business for a debt contracted at the time, as for goods sold, and it turns out to be bad, the person receiving it, may resort to, and recover on, the original cause of action. If the note, however, be sold or discontinued [discounted] . . . there can be no recourse [by the transferee] if it prove bad."⁹⁹

In *Brumby v. Dugan*¹⁰⁰ this court added that the reason for this distinction is that when there is a previous debt, or one contracted for at the time, there is a distinct cause of action, but when the bill is sold there is no cause of action. The distinction was not upheld in *Semmes v. Wilson*,¹⁰¹ but in 1849 *Ellis v. Wild* was followed by Maine in *Baxter v. Duren*.¹⁰² And *Baxter v. Duren* was relied upon by the Maryland court in 1858, in *Fisher v. Rieman*.¹⁰³ Two Illinois cases leave the point in doubt.¹⁰⁴

In *Merriam v. Wolcott*¹⁰⁵ the Massachusetts court repudiated the distinction taken in its earlier case of *Ellis v. Wild* and by the Maine court in *Baxter v. Duren*, saying:

"It is difficult to see any valid reason for such distinction. Whether the purchaser pays cash or discharges a debt in payment for the forged paper the injury is the same to him. There

⁹⁹ The transferor of a bank bill of an insolvent bank was held liable. The case is reported as a note to *Brumby v. Dugan*, 2 Hill 508, 510 (S. C. 1834). The court drew the implication from *Owenson v. Morse*, 7 T. R. 64 (1796), *Ex parte Blackburn*, 10 Ves. 204 (1804), and *Puckford v. Maxwell*, 6 T. R. 52 (1794).

¹⁰⁰ *Supra* note 99, where the transferor of the note of an insolvent third party was held not liable to the transferee as the note had been "sold" to him.

¹⁰¹ *Supra* note 2.

¹⁰² 29 Me. 434, holding that there was an implied warranty of genuineness when the instrument was transferred in "payment" of a debt, either precedent or contemporaneous. But where "the paper is sold . . . there is . . . no implied warranty of the genuineness. The law respecting the sale of goods is applicable. The only implied warranty is, that the seller owns or is lawfully entitled to dispose of the paper." 29 Me. at 441. The court purported to follow the early English cases. The defendant was an undisclosed principal of the seller, a broker, who being thus held not liable, was a competent witness in an action by the transferee against the principal.

¹⁰³ 12 Md. 497. This was also a case where the transferee of a note, bearing the forged signature of the maker and an indorser, sued a public broker, who had not disclosed his principal. Held: plaintiff could not recover.

¹⁰⁴ *Hinckley v. Kersting*, 21 Ill. 247 (1859), is another case of what seems to have been a purchase of a counterfeit bill from a broker. But *Tyler v. Bailey*, 71 Ill. 34 (1873), is apparently *contra*.

¹⁰⁵ 3 Allen 258 (Mass. 1861.) The purchaser of a forged note recovers from the broker who sold it. *Cabot Bank v. Morton*, *supra* note 95.

is in both cases a failure of consideration growing out of a mistake of facts."¹⁰⁶

The court thought that its earlier decision in *Cabot Bank v. Morton*,¹⁰⁷ although not mentioning *Ellis v. Wild*, was contradictory to it. The Ohio court has likewise disapproved of the distinction taken in *Ellis v. Wild* and *Baxter v. Duren*.¹⁰⁸ Similarly, in *Hussey v. Sibley*,¹⁰⁹ the Maine court remarked "that the distinction . . . is, to say the least, somewhat shadowy." But this later Maine case on its facts and decision is not inconsistent with the earlier holding in *Baxter v. Duren*. And in 1883, the Maine court, in *Milliken v. Chapman*,¹¹⁰ said:

"Counsel are in error in supposing that *Baxter v. Duren* was overruled in *Hussey v. Sibley*. . . . The court still maintains the distinction asserted in *Baxter v. Duren* between negotiable paper transferred without indorsement in payment of a debt due or then contracted, and transactions where the paper is sold or bartered as other goods and effects are. . . . Cases in which the note is simply transferred in payment of a debt . . . afford no rule for cases of sale. The creditor . . . very properly . . . is not required . . . to assume any risk. . . . Not so with a sale, in which the price is affected by the risk. . . . What we mean to hold is that he who . . . sells negotiable paper . . . without indorsing it, or making any false representations respecting the solvency of the makers, warrants nothing as to their condition in that respect. . . . The court that ignores as too shadowy, the distinction between paying a debt in failed paper and selling the same in good faith for what the buyer is willing to give will inevitably find itself involved in ascertaining the still more shadowy difference it makes to the purchaser of paper that has a month to run, whether the maker fails on the day of its purchase, or the day before or the day after."¹¹¹

And elsewhere the court argued:

"It would seem to be an anomaly to hold that although he [an unqualified indorser] who procures a note to be discounted with his indorsement, is chargeable with the debt only upon due presentment, demand and notice, still one who sells it outright in good faith, for what it will bring without his indorse-

¹⁰⁶ 3 Allen at 260.

¹⁰⁷ *Supra* note 95.

¹⁰⁸ *Dumont v. Williamson*, 18 Ohio St. 515 (1869).

¹⁰⁹ 66 Me. 192 (1876) (transferor of a void order in payment of an antecedent debt liable to his transferee).

¹¹⁰ 75 Me. 306. In this case the plaintiff sold a note to the defendant at 12% discount, which was paid for with the defendant's due bill, here sued on. The defendant's defense of failure of consideration was not maintainable. Held: not error to refuse defendant's offered instruction that "if at the time of the sale the makers of the note were insolvent the contract was voidable."

¹¹¹ *Ibid.* 317.

ment can be held, practically as a guarantor without demand or notice, on the ground that he impliedly warrants that the makers are solvent at the time of the sale."¹¹²

That is, this is advanced as a reason for not holding the transferor at all when he sells the instrument.

The Minnesota court, after noting that *Ellis v. Wild* had been overruled in Massachusetts but that the corresponding decision in Maine, though first questioned, was later reaffirmed, adopted the distinction between payments and sales and followed *Baxter v. Duren*.¹¹³ The distinction seems also to have been recognized in Iowa.¹¹⁴ The District of Columbia court, however, in *Strauss v. Hensey*, refused to adopt it.¹¹⁵

The Negotiable Instruments Law seems to make no distinction between transfers to pay debts and transfers to a purchaser, for the warranties attach under Section 65 when the instrument has been "negotiated." A negotiation, under Section 30, is a transfer "in such manner as to constitute the transferee the holder thereof." And a holder, by Section 191, is "the payee or indorsee of a bill or note, who is in possession of it or the bearer thereof." Under these Sections it would be difficult to find the basis for the distinction taken in the above cases.

Variation of the Liability by Agreement

Implied warranties against any or all defenses may be negatived by agreement.¹¹⁶ Knowledge of the facts which constitute

¹¹² *Ibid.* 316.

¹¹³ *Brown v. Ames*, 59 Minn. 476, 61 N. W. 448 (1894) (transferee of a note bearing a forged indorsement, sold to him by an agent for an undisclosed principal, could not recover from the agent, seller).

¹¹⁴ *Dille v. White*, 132 Iowa 327, 109 N. W. 909 (1906). The court did not cite the Negotiable Instruments Law.

¹¹⁵ 7 App. D. C. 289 (1895). Referring to *Ellis v. Wild* and *Baxter v. Duren*, the court said: "The cases just mentioned have been virtually overruled." 7 App. D. C. at 293. The court did not refer to *Milliken v. Chapman*.

¹¹⁶ *Strauss v. Hensey*, *supra* note 115; *Bell v. Dagg*, 60 N. Y. 528 (1875); *Beal v. Roberts*, 113 Mass. 525 (1873); *Porter v. Bright*, 82 Pa. 441 (1876).

In *Coffman v. Allin*, 16 Ky. 200 (1815), where the court found that the assignee "agreed to take the bond at his own risk without recourse in any event," it was held that such indorser was not liable to his transferee, the bond bearing the forged signature of the obligor. While the language here is stronger than a mere assignment without recourse, it is questionable whether it should have been interpreted so as to negative the warranty against forgery. Similarly in *O'Sullivan v. Griffith*, 153 Cal. 502, 95 Pac. 873 (1908), the assignment being of "all the transferor's right, title and interest in and to said franchise," the assignor was held not liable although he had no title. This may be because the transaction related to land. The court said: "the franchises were not personal property . . . and the decisions relating to warranties implied from the sale of personalty have no applica-

a defense to a prior party, possessed by the vendee of the instrument at the time of the transfer, also operates as a destruction by implication of the implied warranty of the vendor against this particular defense.¹¹⁷ The question may turn on how much the vendee knows. If he knows all the facts and these facts constitute a defense he cannot resort to his vendor. If he knows some of the facts, but not all, the question becomes more difficult.¹¹⁸

Implied warranties will be negatived if the vendee knows the vendor is selling as an agent for a disclosed principal.¹¹⁹ An agency is not disclosed merely by making known his principal's name and declaring that he is his agent. It may be that the agent, despite these disclosures, is not then selling as agent for the principal named. The buyer may be purchasing solely on the credit of the agent. Hence the rule requiring disclosure of an agency means the disclosure of the fact that the agent is so

tion." In *Baldwin v. Van Deusen*, 37 N. Y. 487 (1868), a stipulation by a transferor of an infant's note, the transferor being ignorant of the infancy, that the note so transferred "was the maker's genuine note and not further or otherwise," was held to negative the warranty of capacity. The court said that there could have been rescission on the ground of mutual mistake of material fact, *i.e.*, the lack of capacity of the maker, but that this right had been lost by unreasonable delay—eight months. *See quære?* One judge regretted the decision because he thought the implied warranty had not been negatived.

¹¹⁷ A transferee with knowledge of the defense that a note is void because illegal cannot recover from his indorser without recourse. *Triplett v. Holly*, 14 Ky. 130 (1823); *Dakin v. Anderson*, 18 Ind. 52 (1862) (bank bills illegally issued). Accord: *Lutz v. Matheny*, 208 Ill. App. 40 (1917) (gambling note); *Frost v. Martin*, 29 N. H. 306 (1854) (partial payment); *Turner v. Keller*, 66 N. Y. 66 (1876) (maker's name was signed by one without authority); *Redden v. Bank*, 66 Kan. 747, 71 Pac. 578 (1903) (note discharged by novation into a judgment); *Ober v. Goodridge*, 27 Gratt. 878 (Va. 1876) (knowledge that prior unqualified indorser discharged by failure to give due notice of dishonor); *Freeman v. Guyer*, 13 Ill. 652 (1852) (amount due was less than that called for by note). In *Moody v. Morris-Roberts Co.*, 38 Idaho 414, 226 Pac. 278 (1923), under the Negotiable Instruments Law, two of the judges thought that knowledge of the defense destroyed the warranty.

¹¹⁸ With respect to the assignment of a bond for deed, the mere knowledge of the assignee that a claim of title was made by a third party did not of itself shift this risk from the assignor to the assignee. *Emmerson v. Claywell*, *supra* note 84.

¹¹⁹ Agent not liable to the purchaser. *Ex parte Bird*, 4 DeG. & S. 271 (1851); *Wilder v. Cowles*, 100 Mass. 487 (1868); *Hutson v. Tyler*, 140 Mo. 252, 41 S. W. 795 (1897); *Strauss v. Hensey*, *supra* note 115. If the agent does not disclose his principal he is liable on the implied warranties to the vendee. *Baxter v. Duren*, *supra* note 102; *Parlange v. Faures*, 14 La. Ann. 448 (1859); *Sere v. Faures*, 15 La. Ann. 189 (1860); *Pugh v. Moore*, *Hymans & Co.*, *supra* note 59; *Hunt v. Sanders*, *supra* note 3; *Lyons v. Miller*, *supra* note 2.

acting in the particular transaction.¹²⁰

If implied warranties may be destroyed by agreement, express warranties may be annexed to the transfer.¹²¹ Moreover, such facts do not destroy the warranties implied in the transaction.¹²² The parol evidence rule furnishes no difficulty when express warranties are entered into by a transferor by delivery. Nor should it furnish any difficulty in cases of transfers by qualified indorsement, because the liability of the vendor is not predicated upon on this so called indorsement at all but is imposed upon him simply because he transferred the instrument. There is no contract in writing that could be varied by parol evidence. And courts have so held,¹²³ although the contrary has

¹²⁰ *Lyons v. Miller*, *supra* note 2, where the court said: "Nor is it material whether the person making the transfer receives the consideration . . . for the use of another; unless he is acting as an agent and discloses not only his agency, but the name of the principal for whom he is acting; in which case he is not a party to the contract, the contract being made with his principal through his agency." 47 Va. at 440. Accord: *Cabot Bank v. Morton*, *supra* note 95; *M. N. Bank v. Gallaudet*, 120 N. Y. 298, 24 N. E. 994 (1890); *Worthington v. Cowles*, 112 Mass. 30 (1873); *Brown v. Ames*, *supra* note 113.

¹²¹ Action against a transferor by delivery has been allowed for breach of an oral warranty that the maker was "financially responsible." *Knauss v. Major*, 111 Mich. 239, 69 N. W. 489 (1896). Accord: *Prudden v. Nester*, 103 Mich. 540, 61 N. W. 777 (1895); *Burtch v. Child, Hulswit & Co.*, 207 Mich. 205, 174 N. W. 170 (1919). Also *Cabot Bank v. Morton*, *supra* note 95 (express warranty of solvency). Accord: *Cardell v. McNiel*, 21 N. Y. 336 (1860); *Bruce v. Burr*, 67 N. Y. 237 (1876); *Kail v. Bell*, *supra* note 87 (express warranty not destroyed by subsequent acceptance of orders indorsed without recourse).

¹²² *Hannum v. Richardson*, 48 Vt. 508 (1875), pointing out that the proof of express warranties does not contradict the implied warranties, and therefore the parol evidence rule does not prevent their proof.

¹²³ In *Harton v. Scales*, Minor 166 (Ala. 1823), where the declaration charged false representation of solvency of the maker, by the indorser without recourse, proof of such statements was admissible. In *Freeman v. Guyer*, *supra* note 82, it was held that the implied warranty of an indorser without recourse that the amount called for by the instrument was due was controlled by parol agreement that the sum due was to be fixed by the statements of two parties named by them. Compare also *Buehler v. Pierce*, *supra* note 77 (express warranty against usury); *Northrup National Bank v. Yates Center National Bank*, 98 Kan. 563, 169 Pac. 403 (1916) (parol evidence admitted to show notes indorsed without recourse were transferred as collateral security).

Implied warranties of an indorser without recourse may be entirely negated by oral agreement. *Carroll v. Nodine*, *supra* note 30. It would seem that the Oregon court takes a different view of this problem under the Negotiable Instruments Law, for in *Smith v. Barner*, 95 Ore. 486, 496, 188 Pac. 216, 219 (1920), the court, after referring to *Carroll v. Nodine*, said: "When it [a negotiable instrument] is transferred by delivery only, the transaction rests in parol, and a defense in parol may then be made. Under the Negotiable Instruments Law when such a note is indorsed without recourse it then becomes and is a written contract.

also found support.¹²⁴

Summary

1. A transferor by delivery and a qualified indorser of a negotiable instrument irrespective of their knowledge of the facts warrant it to be free from all real defenses of all prior parties.

This rule remains true under the Negotiable Instruments Law, Section 65(1) and 65(3) except that Section 65(4) in codifying statement 1(b) below operates as a limitation thereon.

(a) There was one apparent exception, generally recognized. Under certain circumstances in the sale of bonds of governmental bodies and of private corporations (though as to the latter the evidence is less clear) no warranty that the bonds had been issued in compliance with statutory provisions was held to exist.¹²⁵

In so far as the cases where there was held to be no warranty can be regarded as involving the idea of "capacity," the rule remains the same under the last sentence of Section 65(4). In so far as these cases, holding no warranty involve the idea of "validity," they will be governed by the first sentence in Section 65(4). Where there is knowledge of invalidity there will be a warranty. Where there is no knowledge of invalidity there will be no warranty. In a general way there is a codification of *Otis v. Cullum*.

As regards the cases wherein it was held that there was a warranty of compliance with statutory requirements in the sale of public and private securities, in so far as they involve the idea of "capacity" the rule has been changed by Section 65(4). In so far as those cases involve the idea of "validity"—assuming a line of demarcation can be drawn between them—they will be controlled by the first sentence of Section 65(4), under which the warranty will be recreated on proof of knowledge of

The statutory terms and provisions are incorporated in and made a part thereof, and parol evidence is not admissible to explain or vary the written indorsement." There was strong dissent on this point.

¹²⁴ Parol evidence of a warranty of collectibility has been held inadmissible as against an indorser without recourse. *Maxfield v. Jones*, 106 Ark. 346, 153 S. W. 584 (1913). Parol evidence has not been admitted to vary a qualified indorsement. *Heagy v. Umberger*, 10 Serg. & Raw. 339 (Pa. 1823); *Youngberg v. Nelson*, 51 Minn. 172, 53 N. W. 629 (1892); *Odom Realty Co. v. Central Trust Co.*, 22 Ga. App. 711, 97 S. E. 116 (1918); *McMichael v. Jarvis*, 78 Tex. 671, 15 S. W. 111 (1890); *Fayette National Bank v. Ingard*, 34 Idaho 295, 200 Pac. 344 (1921); *Harton v. Scales*, *supra* note 123, at 167, where the court said: "If the action had been on the assignment [indorsement without recourse] parol testimony ought not to have been received."

¹²⁵ The distinction between these two classes of cases is not as clear from the decisions as might be wished. The exception may be called apparent on the theory that the absence of warranty is due to constructive knowledge of the facts possessed by the transferee.

invalidity by the transferor. In short, the general object was to change the rule in *Meyer v. Richards*, and to permit the principle of *Otis v. Cullum* to control the field.

(b) In New York, under the decision of *Littauer v. Goldman*, contrary to the common law rule in England and America generally, there was no warranty that the instrument was free from usury, unless the transferor had knowledge of such fact. This decision might be generalized into the wider proposition that there was no warranty against the real defense of illegality except upon proof of knowledge by the transferor. This rule has been codified by the first sentence of Section 65(4).

2. The cases also show that the transferor by delivery and the qualified indorser of a negotiable instrument irrespective of knowledge warrant it to be free from personal defenses, at least to a transferee who was subject to such defense. The statement in 1(a) could also be regarded as an apparent exception to this rule and the statement in 1(b) constituted a real exception in New York. The rule has been changed by the first sentence of Section 65(4) which requires knowledge of the defense as a prerequisite to the warranty. This conclusion involves the assumption that all personal defenses concern "validity." While the conclusion is not free from doubt, personal defenses seem to fit better into the language of Section 65(4) than they do in 65(1) and 65(3).

3. The transferor by delivery and the qualified indorser of a negotiable instrument irrespective of knowledge also warrant that the instrument is free from all outstanding legal and equitable claims of ownership, which could be successfully asserted against the transferee. This is commonly called the warranty of title. This rule is codified by Section 65(2).

Where the transferee takes free from the claim of ownership the problem is that stated in (5) below. The Negotiable Instruments Law does not expressly deal with this problem. The conflict and uncertainty there indicated could continue under the Act.

4. Statements (1), (2) and (3) can be combined into the single proposition that, at common law, the transferor by delivery and the qualified indorser of a negotiable instrument irrespective of knowledge of the facts warrant that it is an enforceable legal obligation against all prior parties. That is, there is a warranty of the existence of such facts as will enable the transferee to obtain a judgment against all prior parties, in the event of dishonor, if the necessary proceedings on dishonor are duly taken by the transferee. This remains true under the Act except to the extent that the first sentence of Section 65(4) operates as a limitation thereon.

5. There is doubt as to whether the transferor by delivery

and the qualified indorser warrant the instrument to be free from personal defenses and claims of ownership to a holder in due course, who, obviously, could recover free from them.

(a) Where the vendor had knowledge of the defense and participated in the fraud, a Michigan case has held that such fraudulent payee warranted to his transferee, a holder in due course. A California case, on substantially the same facts, held that because the transferee was not subject to the defense, being a holder in due course, there was no warranty.

(b) No cases have been found where the vendor merely had knowledge of the defense or equity but had not profited by the facts which gave rise to them.

(c) Nor have any cases been found where the vendor had no knowledge of the defense or outstanding equity of ownership.

Under the California decision there would obviously be no warranty in cases (b) and (c). Under the Michigan decision, there might be a warranty in case (b) but probably not in case (c). As the Negotiable Instruments Law does not deal with this problem expressly, the same conflict and uncertainty could continue under the Act.

6. All implied warranties could be negated by the express or implied agreement of the parties. While this rule is not expressly incorporated in the Act, it should still be true by virtue of Section 196.

(a) Under some authorities implied warranties were deemed negated by a transfer by way of sale as distinguished from a transfer in satisfaction of a prior or contemporaneous obligation. Most cases held otherwise, finding no difference between transfers by way of sale and transfers in payment of debts. The Act, by applying to all "negotiations," impliedly changes the minority rule.

(b) Knowledge of the facts which constitute the defense or equity, possessed by the transferee at the time of transfer, operate to destroy the implied warranty. While this rule is not expressly incorporated, it should be true under the Act, by virtue of Section 196.

(c) Implied warranties will be negated if the transferee knows the transferor by delivery is acting as the agent for a principal whose name is disclosed to him. This rule is codified by Section 69.

7. Express warranties may be annexed to the transfer by agreement of the parties.

As regards the indorsement without recourse some cases take the view that this is a contract in writing and therefore cannot be added to or subtracted from by parol. The prevailing rule is that it is not a contract in writing and therefore subject to

variation by parol. The Negotiable Instruments Law not dealing with this problem, the conflict could continue.

8. Apparently, at common law, warranties attached to the transfer by delivery of an instrument by one whose indorsement was essential to a transfer of title. Section 65 imposes warranties on "every person negotiating." This could be construed as destroying all warranties of the transferor by delivery who was payee of order paper or of a special indorsee whose indorsement was essential to a negotiation. It would seem more reasonable, however, to give the term "negotiating" a wider meaning such as has been done in those cases which hold that a payee may be a holder in due course.