Negotiable Instruments-Effect of Indorsement in Trust for a Third Person

C.M. Strouss

Follow this and additional works at: https://ideas.dickinsonlaw.psu.edu/dlra

Recommended Citation
Available at: https://ideas.dickinsonlaw.psu.edu/dlra/vol39/iss2/6

This Article is brought to you for free and open access by the Law Reviews at Dickinson Law IDEAS. It has been accepted for inclusion in Dickinson Law Review by an authorized editor of Dickinson Law IDEAS. For more information, please contact lja10@psu.edu.
and to show the reasons why the later cases have repudiated the old, liberal rule, and have now adopted the strict majority rule.

Spencer Gilbert Hall.

NEGOTIABLE INSTRUMENTS—EFFECT OF INDORSEMENT IN TRUST FOR A THIRD PERSON

Under Section 36(3)\(^1\) of the Negotiable Instruments Law, the indorsement of a note "To A in trust for B" is a restrictive indorsement which, by operation of Section 47,\(^2\) terminates the negotiability of the note. Hence the effect of such an indorsement is that the restrictive indorsee is not a holder in due course but takes the note subject to all defenses good against the maker or indorser. Such was the holding in the case of *Gulbranson-Dickinson Company v. Hopkins*,\(^3\) in which the facts were these: The Brenard Manufacturing Company agreed to deliver certain advertising matter to the defendant Hopkins, in consideration for which the latter delivered his promissory note to the Brenard company, payable to said company. The Brenard company, being indebted to the plaintiff Gulbranson-Dickinson Company, delivered this note to the latter, indorsed as follows: "Pay to the order of Iowa City State Bank for credit account of Gulbranson-Dickinson Company." Meanwhile, the Brenard company failed to deliver the advertising matter as per the original contract with the defendant maker, Hopkins. By statute, the Gulbranson company brought an action in its own name as restrictive indorsee against the maker. Held, the plaintiff was a restrictive indorsee under Section 36(3) of the Act; that, under Section 47, the act of indorsement terminated the negotiability of the note; that the plaintiff was therefore not a holder in due course, but took subject to defenses good against the payee Brenard company; that therefore failure of consideration by the Brenard company was a valid defense against the plaintiff.

That such was not the law prior to the Negotiable Instruments Law is indicated in the result obtained in the leading case of *Hook v. Pratt*,\(^4\) decided

\(^1\)Section 36 of the Negotiable Instruments Law, Act of May 16, 1901, is as follows: "An indorsement is restrictive which either:

1. Prohibits the further negotiation of the instrument; or
2. Constitutes the indorsee the agent of the indorser; or
3. Vests the title of the indorsee in trust for, or to the use of, some other person.

But the mere absence of words implying power to negotiate does not make the indorsement restrictive."

\(^2\)Section 47 is as follows: "An instrument negotiable in its origin continues to be negotiable until it has been restrictively indorsed, or discharged by payment or otherwise."

\(^3\)170 Wis. 326, 175 N. W. 93, (1919).

\(^4\)78 N. Y. 371, (1879).
in New York in 1879. There, a draft was drawn by the defendant's intestate, payable to himself and indorsed by him as follows, "Pay to the order of Mrs. Mary Hook for the benefit of her son Charlie." In an action by Mrs. Hook against the estate of the indorser, it was held that the plaintiff, though an indorssee for the use of another, took full legal title to the note so far as the indorser was concerned, and that she was a holder in due course and entitled to recover without affirmatively proving consideration. The result is diametrically opposed to the holding in the Gulbranson case. The latter was decided under Section 36(3) and Section 47 of the Negotiable Instruments Law. Unless the statute was erroneously interpreted, the Negotiable Instruments Law decidedly changes the pre-existing law. The authorities agree that the result of the Gulbranson case is unfortunate, and various interpretations of the Act have been advanced under which the restrictive indorssee of the Section 36(3) type of case could be regarded as a holder in due course.

The following remedy is suggested in "Brannan on Negotiable Instruments."*

"A proper interpretation of Section 47 does not necessitate the result of the Gulbranson case. Sec. 191 provides, 'In this Act, unless the contents require otherwise, indorsement means indorsement coupled with delivery.' When the term indorsement in Sec. 47 is given this meaning it seems that the instrument would not lose its negotiability until after it was delivered to the restrictive indorsee. Thus, the first restrictive indorssee under this interpretation might be a holder in due course if the form of the restrictive indorsement and the nature of the transaction were such as would permit it."

But this construction necessitates drawing a distinction between the first restrictive indorssee and subsequent indorssees. The former would be a holder in due course, the latter would take subject to defenses good against the indorser. There seems to be no reason for drawing this distinction other than to avoid the effect of applying Section 47 to a Section 36(3) type of case. On the other hand, the context of Sections 36, 37, and 47 indicates that it was the intention of the draftsmen to place all restrictive indorssees on the same plane. There was no such distinction before the Negotiable Instruments Law, and it would seem better from a business standpoint to make no distinction between the first and second restrictive indorssee. The construction suggested by Brannan is not inevitable by virtue of the provision in Section 191 which says that indorsement means indorsement plus delivery. The delivery to the first indorssee completes the indorsement contemplated in Section 47 thereby immediately destroying negotiability and all holders thenceforth take subject to defenses, including the first indorssee to whom it has been delivered.

Another section of the Act gives difficulty. Even admitting that Section 47 does not terminate negotiability in the Gulbranson type of case, how can the plaintiff recover in the face of Section 37(2), which says: "A restrictive indorsement confers upon the indorsee the right ... (2) To bring any action thereon that the indorser could bring?" It would seem that this clause properly makes the rights of the indorsee co-extensive with those of the indorser. Yet it has been suggested that the clause is used in a permissive sense and not intended to be restrictive. In other words, the argument is that while the indorsee has all the rights of the indorser, such indorsee's rights are not limited to those of the indorser, but may rise higher. The difficulty with this construction is that Section 37 purports to deal generally with the rights of restrictive indorsees, and makes no distinction between the different types of restrictive indorsees named in Section 36. Therefore, if we adopt this construction as to cases of the type set forth in Section 36(3), we must necessarily adopt it as to cases of the types set forth in Sections 36(1) and 36(2). It is hardly necessary to state that to adopt such a construction as to the latter types named would produce more harmful results than that to correct which the construction is urged. Also, Section 37 states: "... But all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement." This is strong indication that the framers of the Act did not intend the restrictive indorsees to be holders in due course. If they had intended that the first indorsee should be a holder in due course, this statement in Section 37 would have been surplusage. But, proceeding on the assumption that the rights of the first indorsee are limited to those of the indorser, they apparently inserted this statement to avoid the possible construction of the subsequent indorsee as a holder in due course although the first indorsee takes subject to defenses.

It is suggested in Bigelow on "Bills, Notes and Checks" that since a note payable on its face "To A or order in trust for B" is freely negotiable, a negotiable note indorsed "To A in trust for B" should likewise be freely negotiable. This argument seems sound. It is then suggested, however, that to remedy the evil produced in the Gulbranson case, Section 47 should be limited in application to cases of the type described in Section 36(1). But why should

---

\*Section 37 is as follows: "A restrictive indorsement confers upon the indorsee the right:
1. To receive payment of the instrument;
2. To bring any action thereon that the indorser could bring;
3. To transfer his rights as such indorsee, where the form of the indorsement authorizes him to do so.
But all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement."


\*See note 1, supra.
the operation of Section 47 be confined solely to Section 36(1)? Why
should Section 47 not be equally applicable to cases described in Section
36(2)? Furthermore, the construction suggested in Bigelow does not relieve
the difficulty presented in Section 37(2) unless we follow the suggestion
that the clause should be considered permissive, and not restrictive.

Another solution would be to strike off the third clause of Section 36.\textsuperscript{12}
Indorsements of this type were not regarded as truly restrictive at common
law,\textsuperscript{13} and commercial practice does not require that they terminate the
negotiability of the paper. While they are restrictive in the sense that a pur-
chaser takes with notice that he is buying paper subject to a trust, they are
toily different from the restrictive indorsements described in Section 36(1)
and Section 36(2), in which the rights of the indorsee are merely those of an
agent of the indorser. As above indicated, a note payable on its face "To A
or order in trust for B" is freely negotiable.\textsuperscript{14} The Act is silent on that point,
leaving the situation to be controlled by the general law of trust property.
There seems to be no reason why the law should be different where the
negotiable paper is indorsed "To A in trust for B". If the general law is
adequate to control the one, it is adequate to control the other. If the Nego-
tiable Instrument Law is silent as to the trust created on the face of the note,
it seems proper to render it silent as to trusts created by indorsement. By
striking off Section 36(3), an indorsee in trust would no longer be a restrictive
indorsee, and, therefore, no longer within the operation of Sections 37(2) and
47. He would be a holder in due course, taking free of defenses good
against the maker or indorser. In this way results like that of the Gulbranson
case would be avoided.

C. M. Strouss.

EFFECT OF THE UNIFORM STOCK TRANSFER ACT UPON THE
NEGOTIABILITY OF STOCK CERTIFICATES
INDORED IN BLANK

Among the elementary concepts of our common law perhaps none is more
generally accepted than the rule that the legal owner of personal property is

\textsuperscript{10}See note 1, supra.
\textsuperscript{11}See note 6, supra.
\textsuperscript{12}See note 1, supra.
\textsuperscript{13}Hook v. Pratt, 78 N. Y. 371, (1879).
\textsuperscript{14}Squire v. Ordemann, 194 N. Y. 394, 87 N. E. 435 (1909); Taylor v. Harris, 164 Ky.
645, 176 S. W. 168 (1915); Dollar Saving & Trust Co. v. Crawford, 69 W. Va. 109, 70 S. E.
1089, 33 L. R. A. (N.S.) 587 (1911); U. S. Fidelity Co v. Adoue, 104 Tex. 379, 137 S. W.
648, 37 L. R. A. (N.S) 409 (1911).