The Effect of the Adoption of the Proposed Uniform Commercial Code on the Negotiable Instruments Law of Louisiana - Rights of a Holder

Neilson Jacobs
ment will come in the clarification of uncertainties which have been evidenced by conflicting jurisprudence over the past half century. In nearly all areas of uncertainty the drafters of the Code have adopted the rules followed by the majority of the courts. As Louisiana has in most cases settled questions arising under the NIL in accord with the weight of judicial authority, the Code will affect few substantive changes in the law of this state.

The adoption of the Code will result in greater uniformity as to the formal requisites of negotiability than is now present under the NIL. It is submitted that there is nothing contained in Part I of Article 3 which should preclude its adoption in Louisiana, and the clarification which it will provide in many questions will be a definite improvement over the present law.

Sidney B. Galloway

The Effect of the Adoption of the Proposed Uniform Commercial Code on the Negotiable Instruments Law of Louisiana—Rights of a Holder

The Holder in Due Course

A fundamental concept in the law of negotiable instruments is the legal protection which accompanies the status of holder in due course. This protection allows the holder in due course, generally termed a good faith purchaser, to enforce the obligation represented by the instrument regardless of the fact that the drawer or maker may have a valid defense against the party with whom he dealt.1 By thus cutting off defenses available between the immediate parties to the instrument the law provides a vital element of certainty in commercial paper transactions. Under the provisions of the proposed Uniform Commercial Code the holder in due course will still be afforded this legal protection; however, certain innovations and modifications have been made in the requirements for the holder in due course status.

1. Negotiable Instruments Law §§ 57, 58.
The Uniform Negotiable Instruments Law\(^2\) lists five requirements that must be met in order for a purchaser to be a holder in due course: (1) The instrument must be complete and regular on its face; (2) the purchaser must take the instrument before it is overdue and without notice of any previous dishonor; (3) he must take it in good faith, (4) for value and (5) without notice of any infirmities in the instrument or defenses or defects in its title.\(^3\) Under the Code the holder in due course is one who takes the instrument (1) for value, (2) in good faith, (3) without notice that it is overdue or has been dishonored and (4) without notice of any defense against or claim to it on the part of any person.\(^4\)

Two changes are apparent from the above enumeration. The Code does not require without qualification, as does the NIL, that the instrument be complete and regular or that it be taken before maturity. With regard to completeness and regularity, under the Code the question is whether defects on the face of the instrument are such as to put the purchaser on notice of defenses.\(^5\) With regard to maturity, the question is whether the purchaser has notice that he is taking an overdue instrument, not whether the instrument is in fact overdue.\(^6\) These two


\(^3\) NIL § 52; La. R.S. 7:52 (1950): "A holder in due course is a holder who has taken the instrument under the following conditions: (1) That it is complete and regular upon its face; (2) That he became the holder of it before it was overdue, and without notice that it had been previously dishonored, if such was the fact; (3) That he took it in good faith and for value; (4) That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it."

\(^4\) Uniform Commercial Code § 3-302: "(1) A holder in due course is a holder who takes the instrument (a) for value; and (b) in good faith including observance of the reasonable commercial standards of any business in which the holder may be engaged; and (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person. (2) A payee may be a holder in due course. (3) A holder does not become a holder in due course of an instrument; (a) by purchase of it at judicial sale or by taking it under legal process; or (b) by acquiring it in taking over an estate; or (c) by purchasing it as part of a bulk transaction not in regular course of business of the transferor. (4) A purchaser of a limited interest can be a holder in due course only to the extent of the interest purchased."

\(^5\) UCC § 3-302(1)(c); UCC § 3-304(1): "The purchaser has notice of a claim or defense if (a) the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay. . . ."

\(^6\) UCC § 3-302(1)(c). UCC § 3-304(4) sets forth instances in which a purchaser will be held to have notice that he is taking an overdue instru-
changes, among others, will be considered in the following comparison of the requisites of the due course position under the NIL with those under the Commercial Code.

Good faith. The historic decision of Goodman v. Harvey rejected the “prudent man” test of good faith under which it was held that suspicious circumstances alone might be sufficient to prevent a purchaser from becoming a holder in due course. This strict rule was replaced by one which required merely that the purchaser be in actual good faith and hence the fact that suspicious circumstances existed was no longer decisive. Although it is not made clear by the language of the NIL, it is generally understood that this latter rule of subjective good faith was adopted by that act. The Code, specifying that good faith includes the “observance of the reasonable commercial standards of any business in which the holder may be engaged,” makes it clear that the test of good faith is no longer purely subjective but includes an objective element.

This change, however, is clearly not a return to the “prudent man” test. It merely requires that in addition to actual good faith the purchaser’s conduct must measure up to that of honest businessmen. Such a requirement appears wise for two reasons. First, regardless of whether objective or subjective good faith is the test, a determination of either must be based on known facts surrounding the purchaser’s acquisition of the instrument. Certainly it is more realistic to decide whether those known facts show observance of honest business practices than it is to use them as the basis for deter-

---

8. Comment, 81 U. of Pa. L. Rev. 617 (1933). In a Comment, 9 Tulane L. Rev. 128 (1934), it is suggested that although the accepted view restricts good faith under the NIL to a purely subjective standard such a restriction is not warranted. It is pointed out that the subjective test alone would have an undesirable effect on the standard of care in commercial transactions while creating a market among the less honest businessmen for paper subject to defenses. See Britton, Bills and Notes 410 (1943).
9. The general definition of good faith applicable throughout the entire Code is found in § 1-201(19) which provides that good faith “means honesty in fact in the conduct or transaction concerned.” The additional requirement for good faith in commercial paper transactions is found in UCC § 2-302(1)(b).
mining the purchaser's actual state of mind. Second, if an individual seeks the protection afforded a holder in due course it is not unreasonable to require proof of conduct free of suspicion, and in many instances such a requirement will enable defrauded makers to defend more easily against suits brought by unscrupulous persons attempting to recover on paper subject to defenses.10

What the effect of this change in the test of good faith would be, insofar as Louisiana is concerned, is conjectural due to the indecisive treatment of the good faith question by the jurisprudence. Also, additional uncertainty results from the fact that the questions of good faith and notice are often confused, being considered as more or less identical. It appears, however, that in the majority of cases the court has not gone beyond determining whether under the specific facts the holder was or was not in good faith, or that he did or did not have notice. This approach by the courts results in the application, though never expressly so, of a purely objective test; but the standards used, if any, in applying such a test, cannot be discerned from the opinions. Some of the language even goes so far as to indicate that the court is applying the test of "suspicious circumstances."11

Notice. Section 56 of the NIL provides that a purchaser has notice of an infirmity in the instrument or defect in the title of

10. In Stevens v. Gaude, 9 La. App. 664 (1928), the plaintiff, over a period of several years, had purchased a large number of notes from a vendor of radios. The defendant, proving that radios purchased by him were defective, defeated recovery on a note given for the purchase price by showing facts from which it was concluded that the plaintiff was a party interposed. In similar situations where the evidence is not sufficient to defeat recovery on that ground the requirement of "observance of reasonable commercial standards" should be effective to deny the due course status and thus prevent recovery.

11. In Holmes v. Falsho Realty Co., 132 So. 519, 521 (La. App. 1931), the court states: "The notes, being 'bearer' notes, and not yet matured, were negotiable merely by delivery, and any person accepting them in good faith for value would be under no obligation whatsoever to make inquiry, unless some suspicious circumstances arose in connection with their negotiation." In Collins v. Magee, 130 So. 267, 269 (La. App. 1930), the court in its opinion sets forth NIL § 56 under which notice is held when there is actual knowledge of defenses or knowledge of such facts that the purchaser's conduct in taking the instrument amounts to bad faith and then goes on to quote with approval excerpts from decisions prior to the adoption of the NIL to the effect that the purchaser will not be a holder in due course "if the circumstances are of such a strong and pointed character as necessarily to cast a shade on the transaction, and to put the holder on inquiry." See also Polman v. Converse & Co., 173 La. 793, 138 So. 670 (1931); Metairie Savings Bank & Trust Co. v. Harris Finance Corp., 59 So.2d 146 (La. App. 1952); Sandifer v. Stephens, 8 La. App. 546 (1928). But see Maxwell v. W. B. Thompson & Co., 175 La. 252, 143 So. 230 (1932), containing dictum to the effect that constructive notice does not obtain under the NIL, actual knowledge being the test of NIL § 56.
the person negotiating it when he has actual knowledge of the infirmity or defect or knowledge of such facts that his action in taking the instrument amounts to bad faith.\textsuperscript{12} This language resolves notice into a question of whether the purchaser had actual knowledge or whether he was in bad faith. Although there is a difference of opinion as to the interpretation of NIL Section 56,\textsuperscript{13} the two tests contained therein, of actual knowledge or bad faith, are applicable to every situation involving a question of whether a purchaser took an instrument with notice of infirmities or defects of title. The Code lays down no single test to be applied in all cases, but instead provides a general rule, and, in addition, attempts to resolve conflicts presently existing in the jurisprudence by specifying what does and what does not constitute notice in various situations. Section 1-201 contains general definitions applicable to the Code as a whole, three of which deal with notice. Section 1-201(25) defines notice, Section 1-201(26) specifies how one person notifies another,\textsuperscript{14} and Section 1-201(27) sets forth the tests to determine when a person receives notice and when notice to an organization becomes effective.\textsuperscript{15}

Section 1-201(25) provides that "A person has notice of a fact when (a) he has actual knowledge of it; or (b) he has received notice or notification of it; or (c) from all the facts and circumstances known to him at the time in question he has

\begin{enumerate}
\item NIL § 56; La. R.S. 7:56 (1950): "To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith."
\item Comment, 81 U. PA. L. REV. 617 (1933), discusses fully the history and the various interpretations placed on NIL § 56. It is concluded that because of the vague, ambiguous and confusing statements in both the judicial opinions and the treatises it is impossible to determine with any certainty whether the test of bad faith contained therein is objective or subjective. The author advances the subjective test of bad faith as the one to be applied on the ground, among others, that the objective test would restrict negotiability because of the purchaser's fear that a jury might find that under the circumstances a reasonable man would have been in bad faith.
\item UCC § 1-201(26): "A person 'notifies' another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other party actually comes to know of it."
\item UCC § 1-201(27): "A person 'receives' a notice or notification when (a) it comes to his attention; or (b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications.

"Notice or a notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence."
reason to know it exists." Particular attention should be directed to paragraph (c) above. The exact meaning of the language is subject to a difference of opinion; however, it seems clear that the test embodied therein is stricter than that of NIL Section 56 under which notice is held only if the facts known amount to bad faith (in the absence of actual knowledge). Certainly a purchaser having knowledge of a given set of facts might be held to have reason to know of a defense, whereas under the same circumstances he could not be held to be in bad faith. The language of the Code might be interpreted as a return to the long-discarded rule under which suspicious circumstances alone were held to deprive a purchaser of the due course status. Needless to say, such a consequence should be avoided if commercial paper is to retain the necessary degree of liquidity.

As was stated previously, the treatment of the good faith and notice requirements by the Louisiana courts has been vague and ambiguous, little differentiation if any being made between the two concepts. No consolation is derived from the fact that the same confusion exists in other jurisdictions. Thus there is an urgent need for a clear test of notice in commercial paper transactions and the Code does not appear to provide such a test.

A desirable clarification on the question of notice to an organization is found in Section 1-201(27). An example of the problem which may be presented is found in the situation where a number of bearer bonds out of a large issue are stolen and notification is sent to a banking house which later purchases some of the stolen bonds. The Louisiana jurisprudence reveals nothing of a pertinent nature in regard to this facet of the notice problem; however, the United States Supreme Court in the case of Graham v. White-Phillips Co. held that the test of good faith is to be applied as of the date of the purchase and that notice received at a previous date is only prima facie evidence of bad faith. The possibility of "organizational forgetting" is eliminated by the section of the Code referred to above which provides in terms that an employee has notice from the time it is brought to his attention or from the time it would have been brought to his attention if the organization had exercised due diligence.

As previously stated, the subsections of Section 1-201 discussed above are general provisions defining terms which are

16. See note 13 supra.
17. 296 U.S. 27 (1935).
used throughout the entire Code. Section 3-304, set out in the
note for reference,\textsuperscript{18} is the principal section insofar as notice
in commercial paper transactions is concerned. Subsection 1(a)
replaces the requirement of the NIL that the instrument must
be "complete and regular on its face." This requirement does
not appear to have been given judicial gloss by any Louisiana
decision; therefore only the statutory law as embodied in the NIL
will be affected by the Code. As is stated by the draftsmen in
the comment following Section 3-304, irregularity is properly
a question of notice to the purchaser. One should not be denied

\textsuperscript{18} UCC §3-304: "(1) The purchaser has notice of a claim or defense if
(a) the instrument is so incomplete, bears such visible evidence of forgery
or alteration, or is otherwise so irregular as to call into question its validity,
terms or ownership or to create an ambiguity as to the party to pay; or
(b) the purchaser has notice that the obligation of any party is voidable in
whole or in part, or that all parties have been discharged.
"(2) The purchaser has notice of a claim against the instrument when
he has reasonable grounds to believe (a) that the transfer to him is a
preference voidable under the law of bankruptcy or insolvency; (b) that a
fiduciary has negotiated the instrument in payment of or as security for
his own debt or in any transaction for his own benefit or otherwise in
breach of duty.
"(3) Except as provided with respect to conditional, trust or collection
indorsements in the course of bank collections (Sections 4-203 and 4-205),
the purchaser also has notice of a claim against the instrument if it has
previously been indorsed conditionally or in such manner as to prohibit
further negotiation and such indorsement has not been cancelled.
"(4) The purchaser has notice that an instrument is overdue if he has
reasonable grounds to believe

(a) that any part of the principal amount is overdue or that there is
an uncured default in payment of another instrument of the same
series; or
"(b) that acceleration of the instrument has been made; or
"(c) that he is taking a demand instrument after demand has been
made or more than a reasonable length of time after its issue. A
reasonable time for a check drawn and payable within the states
and territories of the United States and the District of Columbia
is presumed to be thirty days.
"(5) Knowledge of the following facts does not of itself give the pur-
chaser notice of a defense or claim

(a) that the instrument is antedated or postdated;
"(b) that it was issued or negotiated in return for an executory prom-
ise or accompanied by a separate agreement, unless the purchaser
has notice that a defense or claim has arisen from the terms
thereof;
"(c) that any party has signed for accommodation;
"(d) that an incomplete instrument has been completed, unless the
purchaser has notice of any improper completion;
"(e) that any person negotiating the instrument is or was a fiduciary;
"(f) that there has been default in payment of interest on the instru-
ment or in payment of any other instrument, except one of the
same series.
"(6) The filing or recording of a document does not of itself constitute
notice within the provisions of this Article to a person who would otherwise
be a holder in due course.
"(7) To be effective notice must be received at such time and in such
manner as to give a reasonable opportunity to act on it."
the due course position merely because of some minor particular, such as a change in date, which would not even excite suspicion. Although some modification of the present rule of the NIL is desirable, the language used in this subsection, as has been pointed out by Beutel, is certain to cause difficulties in interpretation.\textsuperscript{19} If, under the terms of that subsection, the instrument is so incomplete or otherwise irregular as to call into question its validity, terms of ownership or to create an ambiguity as to the party to pay, the purchaser is held to be on notice of a "claim or defense." The terms "claim or defense" are not defined by the Code and their meaning as used in this connection is obviously not that which they commonly convey. If a purchaser takes an instrument on which the sum due has been crossed out and a different amount substituted therefor, clearly, under the Code provision, this would constitute an "irregularity" sufficient to put the purchaser on notice of a "claim or defense." Actually, there is no claim or defense, merely an infirmity in the instrument. On the other hand, under Subsection 1 (b) the purchaser has notice of a "claim or defense" if he has notice that "all parties have been discharged." Thus the instrument may be taken with knowledge that a co-maker, surety, or endorser has been discharged and yet the purchaser is not on notice of a defense because he does not have notice "that all parties have been discharged." (Italics supplied.) How can it be said that a purchaser with knowledge of the discharge of one of the obligors on an instrument takes it without notice of a defense?

Subsections 2 (b) and 5 (e) will allow a purchaser to become a holder in due course, although he takes an instrument from one whom he knows to be a fiduciary, provided he does not have "reasonable grounds to believe" the fiduciary has breached his duty. It seems questionable to deny the due course position to an individual who dealt with an agent on the basis of a finding that at the time of the transaction he had "reasonable grounds to believe" that the agent was violating a trust. This language might unhappily be interpreted as placing persons dealing with fiduciaries on a kind of constructive notice in case of misappropriation.\textsuperscript{20}

\textsuperscript{20.} The Uniform Fiduciaries Law was adopted by La. Acts 1924, No. 226, p. 438; La. R.S. 9:3801-3814 (1950). In the comment by the commissioners following Section 3-304 of the Commercial Code it is stated that Subsection
The holder in due course under the NIL must have taken the instrument before it was overdue. Under the Code a purchaser may take an overdue instrument and yet be a holder in due course; the requirement is that he take it without notice that it is overdue. Subsection (4) of Section 3-304 specifies certain instances in which the purchaser has notice that the instrument is overdue. It provides in part, using the questionable language "reasonable grounds to believe," commented on above, that a purchaser "has notice that an instrument is overdue if he has reasonable grounds to believe that any part of the principal amount is overdue or that there is an uncured default in the payment of another instrument of the same series." Thus it will be possible for the purchaser of an installment note to become a holder in due course although there has been a default on one of the installments provided he is not on notice of the default. This result cannot be reached under the NIL since the purchaser of such a note is technically taking it after maturity. In view of this relaxation of the strict NIL rule requiring purchase before maturity it is anomalous to find that the latter part of the above quoted provision will deny the due course status to a purchaser who takes one of a series of notes prior to its maturity but with notice that another note in the same series has not been paid at maturity. It seems illogical to hold that knowledge of a default on one note of a series constitutes

(2)(b) follows the policy of the Uniform Fiduciaries Law, and specifies the same elements as notice of improper conduct of a fiduciary. However, a comparison of the language in the pertinent sections does not seem to support this statement. Section 6 of the Uniform Fiduciaries Law provides: "If a check or other bill of exchange is drawn by a fiduciary as such, or in the name of his principal by a fiduciary empowered to draw such instrument in the name of his principal, payable to the fiduciary personally, or payable to a third person and by him transferred to the fiduciary, and is thereafter transferred by the fiduciary, whether in payment of a personal debt of the fiduciary or otherwise, the transferee is not bound to inquire whether the fiduciary is committing a breach of his obligation as fiduciary in transferring the instrument, and is not chargeable with notice that the fiduciary is committing a breach of his obligation as fiduciary unless he takes the instrument with actual knowledge of such breach, or with the knowledge of such facts that his action in taking the instrument amounts to bad faith." The tests of actual knowledge or bad faith contained in this provision are the same as those found in NIL § 56, and, as pointed out in another connection, the test of "reasonable grounds to believe" of the Code clearly appears to hold purchasers to a stricter degree of care than the test of "bad faith." Beutel, Comparison of the Proposed Commercial Code, Article 3, and the Negotiable Instruments Law, 30 Neb. L. Rev. 531, 548 (1951), states that Subsection (2) contemplates constructive notice of fiduciary claims thus dragging in all the exceptions and many more which the Uniform Fiduciary Act created to NIL § 56.

21. NIL § 52, quoted note 3 supra.
22. UCC § 3-302(1)(c), quoted note 4 supra.
notice to the purchaser that all other notes of the same series are overdue although by their terms they have not reached maturity. Furthermore, in most instances the fact that one note is not paid at maturity indicates only that the maker was unable to pay at that time and would not put the purchaser on notice of possible defenses. This provision would effect a change of the existing law in a majority of jurisdictions, and dictum in one Louisiana decision indicates that it would effect a change here also.\(^\text{24}\)

**Value.** Section 25 of the NIL provides that “value is any consideration sufficient to support a simple contract.” Since a promise to pay is considered sufficient consideration to support a contract it would seem that the purchaser of a negotiable instrument who gives such a promise has given value and thus, insofar as that requirement for the due course position is concerned, may be a holder in due course.\(^\text{25}\) However, NIL Section 54 provides that a transferee who receives notice of a defense before paying the full amount agreed upon is a holder in due course only to the extent of the amount actually paid.\(^\text{26}\) Thus a purchaser who has given merely a promise to pay would not appear to have given value under Section 54 because nothing has actually been paid.\(^\text{27}\) The weight of judicial authority has followed Section 54 in holding that a bank which receives a negotiable instrument from a depositor and merely credits his account has not given value.\(^\text{28}\) The bank’s promise to pay upon demand of the depositor is not considered as value. The Code has extended this rule regarding bank credit to cover all transactions involving commercial paper by providing that no executory promise to give value is value itself except where a nego-

\(^{24}\) In Bank of Eudora v. Crowe, 2 La. App. 669 (1925), the court states that there was no evidence showing that the holder of two notes of a series had knowledge of a previous default on another note of the series; however, authorities are cited with approval which hold that the purchaser of a note before maturity may be a holder in due course although notes in the same series are not paid. See Britton, Bills and Notes 454 (1943).


\(^{26}\) NIL § 54; La. R.S. 7:54 (1950): “Where the transferee receives notice of any infirmity in the instrument or defect in the title of the person negotiating the same before he has paid the full amount agreed to be paid therefor, he will be deemed a holder in due course only to the extent of the amount theretofore paid by him.”

\(^{27}\) Brannan, Negotiable Instruments Law 499 (7th ed., Beutel, 1948); Britton, Bills and Notes 400 (1943). Beutel contends that NIL § 54 does not apply to credit because the credit itself is the full amount to be given.

\(^{28}\) Britton, Bills and Notes § 97 (1943).
tiable instrument is given or an irrevocable commitment is made to a third person.\textsuperscript{29}

The question of whether bank credit constitutes value does not appear to be settled in Louisiana. A court of appeal decision\textsuperscript{30} expressly adopted the rule that mere crediting of an account is value; however, a careful examination of the facts of that case reveals that the language used in the opinion is somewhat broader than was required for the decision; thus the holding cannot be relied upon as the basis for any unqualified prediction as to the result of future litigation on this question. The facts of the case may be stated as follows: The amount of a draft drawn by the defendant was credited to his account by bank A, the payee of the draft. The draft was then forwarded to the bank B, which had possession of it when Bank A failed. Defendant notified the drawee not to pay the draft and Bank B sought to enforce payment against the defendant. The defense was that Bank A was only an agent for collection, acquired no title to the draft, and therefore could not pass title to bank B. The court held that the defendant had unrestrictedly endorsed the draft and that the crediting of his account constituted a giving of value, at which time the bank became owner of the draft. Admittedly, the question of whether crediting of an account is to be considered as value so as to make a bank a holder in due course was not presented. The issue was whether the bank had become owner of the draft. However, language in the opinion may be considered as indicating that in Louisiana credit would be considered as value under any circumstances. If that be true the adoption of the Code would establish a rule directly to the contrary.

If the credit itself is not considered value, what is the result in a case where a bank seeks to establish itself as a holder in due course? In that event it becomes necessary to determine the extent to which the credit has been withdrawn, for the

\textsuperscript{29} UCC § 3-303: "A holder takes the instrument for value (a) to the extent that the agreed consideration has been performed or that he acquires a security interest in or a lien on the instrument otherwise than by legal process; or (b) when he takes the instrument in payment of or as security for an antecedent claim against any person whether or not the claim is due; or (c) when he gives a negotiable instrument for it or makes an irrevocable commitment to a third person."

\textsuperscript{30} First National Bank v. Cross & Napper, 157 So. 636 (La. App. 1934). See \textit{In re} liquidation of Canal Bank & Trust Co., 181 La. 856, 160 So. 609 (1935), which held that a bank in which an instrument has been deposited for credit has title and the depositor cannot recover it back after failure of the bank.
amount withdrawn has actually been paid and to that extent the bank may be a holder in due course. This determination will be necessary in applying the rule adopted by the Code, the rule that credit is not value. In ascertaining the extent to which credit has been drawn on, the majority of courts apply what is commonly known as the "first money in, first money out" rule. This means simply that the first withdrawals are charged against the first credits. A minority rule makes the bank a holder for value only if the balance in the account falls below the amount of the deposited item.\(^3\) The application of these accounting techniques is often beset with difficulties, especially in cases involving active accounts where numerous deposits and withdrawals are made during the interval between the deposit and the dishonor of the litigated instrument.\(^3\) Thus it can readily be seen that, insofar as simplicity is concerned, the rule that credit constitutes value has much to be said in its favor.

Those who are opposed to considering credit as value contend (1) that since the bank may charge back the account of its depositor it does not need the protection afforded a holder in due course and (2) that to give it this protection irrespective of the right to charge back will allow inequitable recoveries from defrauded makers.\(^3\) On careful analysis, however, these contentions do not appear as sound as they might on first impression. The rule that credit must be withdrawn before value has been given does not alter the fact that a bank may become a holder in due course although it might have charged back the account. For example, if \(A\) deposits \(Y\)'s note for $100 and immediately withdraws $100, the bank in suing on the note is a holder for value. This is true although \(A\) deposits another $100 in cash immediately after \(Y\) has refused the bank's demand for payment and thus establishes a balance sufficient for a full charge back. In this example it is clear that credit has been

---

31. The Code specifically adopts the "first-in, first-out" rule. Section 4-209 provides: "For purposes of determining its status as a holder in due course, the bank has given value to the extent that it has a security interest in an item." Section 4-208 provides: 

(a) in case of an item deposited in an account to the extent to which credit given for the item has been withdrawn or applied; 

(b) For the purpose of this section, credits first given are first withdrawn." 

32. See, generally, Brannan, Negotiable Instruments Law 506 (7th ed., Beutel, 1948); Britton, Bills and Notes § 97 (1943).

withdrawn; therefore either of the two accounting tests mentioned above make the bank a holder for value. In addition, if the bank has available the simple method of charge back it is seldom that it would undergo the risk and burden of litigation. Practically speaking this is the soundest basis for refuting the arguments opposed to considering credit as value.\textsuperscript{34}

In conclusion, it appears that the arguments for rejecting the rule that bank credit constitutes value are not convincing. That rule offers a clear, simple test, unhampered by technicalities of application, and thus it is believed that the present definition of value in the Code should be replaced by one which makes it clear that a promise to pay is value.

The Payee as a Holder in Due Course

Generally speaking a payee cannot be a holder in due course because in most instances he deals directly with the drawer or maker and therefore has knowledge of any defenses against the instrument. However, the common law held that a payee might be a holder in due course if he met the requisites of that position.\textsuperscript{35} It sometimes happens that the payee deals solely with an agent of the maker and in those cases, among others, there would seem to be nothing inherent in the status of the payee as such to prevent him from becoming a holder in due course. Subsequent to the adoption of the NIL, and despite the logic of the view which allows a payee to be a holder in due course, a conflict developed on this question due to different interpretations of the act.\textsuperscript{36} The Code will resolve this dispute by a specific provision declaring that a payee may be a holder in due course.\textsuperscript{37} In view of the conflict presently existing this is a desirable clarification; however, the same result may be reached under what appears to be the soundest interpretation of the NIL.\textsuperscript{38}

\begin{itemize}
\item \textsuperscript{34} For a complete consideration of the change incorporated in the UCC, see Note, \textit{Bank Credit as Value: The Commercial Code Article III, 57 Yale L.J.} 1419 (1948).
\item \textsuperscript{35} Britton, Bills and Notes 508 (1943).
\item \textsuperscript{36} Ibid.
\item \textsuperscript{37} UCC § 3-302(2).
\item \textsuperscript{38} Brannan, Negotiable Instruments Law 675 et seq. (7th ed., Beutel, 1948). This interpretation is illustrated as follows: Section 52 defines a holder in due course as a "holder" who has taken the instrument under the conditions set forth in that section. Section 191 defines "holder" as a "payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof." Thus, replacing the word "holder" in Section 52 with the definition of that term found in Section 192, Section 52 would read "a holder in due course is a payee or indorsee who is in possession," etc. Up to this point it would
\end{itemize}
Only one Louisiana case was found in which the factual situation called for a consideration of the question of whether a payee may be a holder in due course. The payee sued the makers and co-makers of a note. The note had been delivered by the maker to the payee out of the presence of the co-makers. The court first found that the evidence was sufficient to establish the authenticity of only one of the alleged signatures of the co-makers. As to that co-maker the court held that the payee was free to recover regardless of the fact that the amount of the note had been misrepresented by the maker in obtaining the co-maker's signature. The plaintiff-payee was a purchaser in good faith and equities between the maker and co-maker could not defeat his recovery. The court in this case discussed neither the NIL nor the question of whether a payee may be a holder in due course; however, the plaintiff-payee was afforded the protection associated with the status of holder in due course regardless of the fact that he was not expressly designated as such. Although it would be desirable to have a clearer judicial expression as the basis for any conclusion, it would appear that the present Louisiana law on this question is in accord with the Code.

Rights of a Holder in Due Course: Non-Delivery of an Incomplete Instrument No Longer a Real Defense

Section 15 of the NIL provides that "where an incomplete instrument has not been delivered it will not, if completed and negotiated, without authority, be a valid contract in the hands of any holder, as against any person whose signature was placed thereon before delivery." Thus under this section even a holder in due course cannot recover on an instrument which was not completed by the maker or drawer and which was not delivered by him. NIL Section 16 states that where the instrument is in the hands of a holder in due course a valid delivery by

40. NIL § 15; LA. R.S. 7:15 (1950).
all prior parties is conclusively presumed. Under this section the holder in due course may recover on an instrument which was completed by the maker or drawer although it was not delivered by him. Under Section 14 an instrument issued in incomplete form and subsequently filled up may be enforced by a holder in due course as actually completed. Stated concisely, the result of these three NIL sections is that non-delivery and incompleteness of an instrument are personal defenses when considered individually and will not defeat a holder in due course, but the two together constitute a real defense valid against such a holder. It is difficult to draw any rational distinction between a due course holder's position in respect to two checks stolen from the drawer, one drawn to "cash" for a stated sum and the other signed in blank, yet the NIL does just that. The good faith purchaser takes both instruments under the same circumstances and there is no justifiable basis for allowing recovery on the one and not on the other. In both instances careless handling of the checks by the drawer is the cause of any loss; therefore he should be the one to bear it.

41. NIL § 16; La. R.S. 7:16 (1950): "Every contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto.

"As between immediate parties, and as regards a remote party other than a holder in due course, the delivery, in order to be effectual, must be made either by or under the authority of the party making, drawing, accepting, or indorsing, as the case may be; and in such case the delivery may be shown to have been conditional, or for a special purpose only, and not for the purpose of transferring the property in the instrument. But 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. And where the instrument is no longer in the possession of a party whose signature appears thereon, a valid and intentional delivery by him is presumed until the contrary is proved."

42. NIL § 14; La. R.S. 7:14 (1950): "Where the instrument is wanting in any material particular, the person in possession thereof has a prima facie authority to complete it by filling up the blanks therein. And a signature on a blank paper delivered by the person making the signature in order that the paper may be converted into a negotiable instrument operates as a prima facie authority to fill it up as such for any amount. In order, however, that any such instrument when completed may be enforced against any person who became a party thereto prior to its completion, it must be filled up strictly in accordance with the authority given and within a reasonable time. But if any such instrument, after completion, is negotiated to a holder in due course, it is valid and effectual for all purposes in his hands, and he may enforce it as if it had been filled up strictly in accordance with the authority given and within a reasonable time."

43. No Louisiana cases could be found in which non-delivery of an incomplete instrument was raised as a defense against a holder in due course; however, the cases decided under the NIL recognize it as valid against such a holder. See Button, Bills and Notes § 88 (1943).

44. For a discussion of this problem and a favorable comment on the change made by the Code, see Sutherland, Article 5—Logic, Experience and Negotiable Paper, [1952] Wis. L. Rev. 230, 245.
The Code makes a much-needed change in correcting this inequity done the holder in due course. Section 3-115, together with Section 3-407, states that even though the incomplete instrument is not delivered a holder in due course may enforce it as completed.45

**Fraud as a Real Defense**

At common law two types of fraud which might be involved in the execution of a negotiable instrument were distinguished. "Fraud in the factum" was held to exist when a person, without negligence, signed a negotiable instrument but did so because the true character of the instrument was misrepresented. For example, the maker of a note might have been led to believe that he was signing a release. This type of fraud was recognized as a real defense which might be raised against a holder in due course provided there were no grounds for estoppel present. On the other hand, where an individual was induced by misrepresentation to sign what he knew to be a negotiable instrument, such was held to be "fraud in the inducement" and was considered a personal defense not available against the holder in due course.46 The NIL does not expressly deal with what the common law termed "fraud in the factum"; and Britton takes the position that the act may be subject to two interpretations, one giving such fraud the status of a real defense, the other placing it in the category of equitable defenses.47 However, the majority of cases decided since the adoption of the act have held to the common law rule that "fraud in the factum" is a real defense.48

Louisiana's position on this question appears to be contrary to the weight of authority. Although the NIL was not discussed nor any distinction between the types of fraud recognized, the holding in the case of *General Motors Acceptance Corp. v. Schoneke* stands for the proposition that "fraud in the fac-

45. UCC § 3-115(2): "If the completion is unauthorized the rules as to material alteration apply (Section 3-407), even though the paper was not delivered by the maker or drawer; but the burden of establishing that any completion is unauthorized is on the party so asserting."

UCC § 3-407(3): "A subsequent holder in due course may in all cases enforce the instrument according to its original tenor, and when an incomplete instrument has been completed, he may enforce it as completed."

46. BRANNAN, NEGOTIABLE INSTRUMENTS LAW 758 et seq. (7th ed., Beutel, 1948); BRITTON, BILLS AND NOTES § 130 (1943).


48. See note 46 supra.
“(c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms.”

Under this provision the test will no longer be whether the party knew or did not know that he was signing a negotiable instrument. This change recognizes that it is not the type of fraud which invalidates the instrument but the lack of consent. Since lack of consent is present whether the party was induced...
to sign a negotiable instrument believing it to be a receipt or whether he signed knowing it to be a negotiable instrument but deceived as to its essential terms, in both cases the defense should be available.

Although this provision will work a more drastic change in Louisiana than in those jurisdictions which at present consider fraud in factum a real defense, it is a change that is needed. The phrase "with neither knowledge nor reasonable opportunity to obtain knowledge" will restrict the availability of this defense to those instances in which the signer is deserving of protection. Such cases are rare and to protect the defrauded individual will not cause any noticeable detriment to the liquidity of commercial paper.\textsuperscript{52}

Rights of One Not a Holder in Due Course: Defendant May Not Set up Claims of a Third Party

Under the NIL an obligor may successfully defend an action on a negotiable instrument if he can prove that the plaintiff has no legal title to the instrument.\textsuperscript{53} However, there is a conflict on the question of whether the holder of the legal title may be defeated by an obligor who, having no defense of his own, seeks to interpose a claim of a third party to the instrument.\textsuperscript{54} The NIL does not deal with the problem expressly and the implications from a number of sections are inconsistent. Certain sections deny the right of a defendant, in the cases specifically covered, to set up a third party's claim to the instrument, while other sections may be interpreted so as to give the defendant such a right in the instances not specifically treated elsewhere.\textsuperscript{55}

The Code clarifies these inconsistencies. Section 3-306 provides that "unless he has the rights of a holder in due course any person takes the instrument subject to . . . (d) the defense

\textsuperscript{52} Britton, \textit{Fraud in the Inception of Bills and Notes}, 9 \textit{CORNELL L. Q.} 140 (1923), notes that the number of cases involving fraud has decreased since 1890.

\textsuperscript{53} \textit{Britton, Bills and Notes} 749 (1943).

\textsuperscript{54} \textit{Id.} at 752.

\textsuperscript{55} \textit{Id.} \S 159, for a complete discussion of the problem and analysis of the pertinent NIL sections. It is pointed out that Sections 60, 61, 62, 22 and 39 "are in harmony with a general rule which would deny the defendant the right to set up a lack of capacity in any indorser to negotiate and to set up any \textit{jus tertii}, but these sections do not, in express terms, go that far. . . . On the other hand, implications from Sections 59, 51, 119 and 88 point in the direction of the right of the defendant to set up, successfully, any \textit{jus tertii} or defective title in the plaintiff."
that he or a person through whom he holds the instrument acquired it by theft. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party." (Italics supplied.) The Louisiana jurisprudence is in accord with the general rule stated in this section and, although no cases could be found involving theft, the exception made is consistent with the general principle which denies to a thief the aid of the courts in perpetrating his wrongdoing.

In view of the difficulties encountered under the NIL the inclusion of a provision in the Code specifically prohibiting a defendant from setting up claims of third parties seems wise. As is stated in the comment following Section 3-306, "the contract of the obligor is to pay the holder of the instrument and the claims of other persons against the holder are not his concern. He is not required to set up such a claim as a defense, since he usually will have no satisfactory evidence of his own on the issue; and the provision that he may not do so is intended as much for his protection as for that of the holder."

Burden of Proof and Presumptions

Section 3-307, set out in the note, is an expanded version

56. UCC § 3-306 provides in full: "Unless he has the rights of a holder in due course any person takes the instrument subject to "(a) all valid claims to it on the part of any person; and
(b) all defenses of any party which would be available in an action on a simple contract; and
(c) the defenses of want or failure of consideration, non-performance of any condition precedent, non-delivery, or delivery for a special purpose; and
(d) the defense that he or a person through whom he holds the instrument acquired it by theft. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party."

57. Equipment Finance Corp. v. Atkins, 139 So. 154 (1932); Quick v. Littlejohn, 156 La. 369, 100 So. 531 (1924).
58. UCC § 3-307: "(1) Unless specifically denied in the pleadings each signature on an instrument is admitted. When the effectiveness of a signature is put in issue
(a) the burden of establishing it is on the party claiming under the signature; but
(b) the signature is presumed to be genuine or authorized except where the action is to enforce the obligation of a purported signer who has died or become incompetent before proof is required.
(2) When signatures are admitted or established, production of the instrument entitles a holder to recover on it unless the defendant establishes a defense.
(3) After evidence of a defense has been introduced a person claiming the rights of a holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course."
of NIL Section 59 and should serve to clear up some procedural conflicts presently existing. Under Subsections (1) and (1)(b) of the Code provision a defendant who intends to put at issue the validity of any signature on an instrument must not only specifically deny it in his pleadings but must also introduce evidence in support of his denial before the plaintiff is put to proof of its genuineness. This will effect a change in the majority of jurisdictions, including Louisiana, where it is held that a proper denial of genuineness is in itself sufficient to force the introduction of evidence by the plaintiff. This change seems proper. Forged or unauthorized signatures are infrequent and it seems just that the defendant, who usually will have evidence on this issue more readily available, should be called upon to put in some proof to support his allegation. Mere denial alone should not be sufficient.

Section 59 of the NIL states that upon proof of a "defect in title" the burden shifts to the plaintiff to establish himself as a holder in due course if he is to overcome the defense thus raised by the defendant. Since Section 55 in defining "defect of title" does not include want or failure of consideration, the majority of courts hold that proof of either of these defenses does not cause the burden to shift. Subsection (3) of Section 3-307 of the Code will change this prevailing rule. It is made clear that proof of want or failure of consideration by the maker will put the plaintiff to proof of his due course position. Of

59. NIL § 59; LA. R.S. 7:59 (1950): "Every holder is deemed prima facie to be a holder in due course; but when it is shown that the title of any person who has negotiated the instrument was defective, the burden is on the holder to prove that he or some person under whom he claims acquired the title as holder in due course. But the last mentioned rule does not apply in favor of a party who became bound on the instrument prior to the acquisition of such defective title."


61. See note 59 supra.

62. NIL § 55; LA. R.S. 7:55 (1950): "The title of a person who negotiates an instrument is defective within the meaning of this Chapter when he obtained the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud."

63. BRITTON, BILLS AND NOTES 432 et seq. (1943).

64. UCC § 3-307(3), quoted note 58 supra. UCC § 3-306 provides in part: "Unless he has the rights of holder in due course any person takes the instrument subject to"

"(c) the defenses of want or failure of consideration, non-performance of any condition precedent, non-delivery, or delivery for a special purpose."
course, the plaintiff need not do so if he believes that the defendant's evidence is too weak to convince the trier of fact and prefers to submit the case without attempting to establish himself as a holder in due course. Louisiana is in accord with the rule of the Code.65 This is the sounder view, since there can be no logical reason for holding that the burden shifts upon proof of certain kinds of personal defenses while refusing to follow the rule in regard to want or failure of consideration which are also personal defenses.

Two other questions not specifically dealt with by the NIL are expressly covered by Subsection (3). Under the language “burden to prove” of NIL Section 5966 there is a conflict as to whether the plaintiff's burden of proving himself a holder in due course, when that question is put at issue, is one of persuasion or of merely introducing evidence.67 The phrase “burden of establishing” used in Subsection (3) is defined as burden of persuasion;68 thus the majority rule on this question was adopted. Louisiana is in accord.69 Britton supports this position on the grounds that a bona fide purchaser will almost certainly convince the jury that he is such while a purchaser of paper obtained in a questionable manner will find it difficult to do so. Because the full burden of persuasion is on one seeking the due course position the latter type of holder will often fail in his efforts to recover against a maker who has been deceived by the payee.70

Although the NIL does not state that one seeking to establish himself as a holder in due course must discharge his burden in respect to each requisite of the due course status, namely, that he acquired in good faith, for value, and before maturity, the cases decided under the act, including those in Louisiana, are practically unanimous in holding that he must.71 At common law there was a dissent from this position, some of the

66. See note 59 supra.
67. BRITTON, BILLS AND NOTES 432 et seq. (1943).
68. UCC § 1-201(8): “'Burden of establishing' a fact means the burden of persuading the triers of fact that the existence of the fact is more probable than its non-existence.”
70. BRITTON, BILLS AND NOTES 437 et seq. (1943).
71. Id. at 438 et seq.; Commercial Credit Corp. v. Setliff, 44 So.2d 167 (La. App. 1950).
cases holding that a presumption of good faith was raised by proof that value was given. The Code provides that the plaintiff must establish that he is "in all respects a holder in due course," thus resolving any doubt on this question.

Conclusion

The difficulties inherent in any attempt to formulate definite conclusions as to the changes which will be effected in the present law of negotiable instruments by a comprehensive revision such as the Commercial Code are readily apparent. The draftsmen have not only rearranged the subject matter of the NIL but also have made substantial changes in language; thus the problem of differentiating substantive change from mere re-wording is very real. The scope of this comment has been restricted to a consideration of what appear to be some of the more important changes and modifications. For the most part, because of the detailed nature of the subject matter treated, the conclusions drawn with respect to the particular provisions discussed must stand alone. Generally, a brief survey of these conclusions reveals that the draftsmen have done a commendable job in eliminating confusion and conflict presently existing. Thus the addition of an objective element in the test of good faith for the due course position, the inclusion of a specific provision allowing a payee to become a holder in due course and the elimination of non-delivery of an incomplete instrument as a real defense should be recognized as distinct improvements in the law. Also, the Code provisions dealing with fraud as a real defense, the claims of third parties to an instrument and burden of proof provide workable rules which should reach the proper results. However, any undertaking of the magnitude of the Commercial Code is likely to contain elements subject to valid criticism. Of the particular provisions considered herein this observation would seem to be true of the sections setting forth the notice and value requisites of the holder in due course status. As previously pointed out, it is believed that the rule that a promise to pay is value should be substituted for the present Code provision to the contrary. Insofar as notice to the purchaser is concerned, although sound results may be reached in particular instances by application of the Code provisions, it would seem that the approach of the NIL in specify-

73. UCC § 3-307(3), quoted note 58 supra.
ing general rather than particular rules has much to be said in its favor. As no two cases present the same factual situation the end results of efforts to resolve conflicts by providing numerous solutions may be confusion rather than clarification. At the very least it seems fair to conclude that some changes in language should be made if the Code is to be adopted.

Neilson Jacobs

Private Nuisance in Louisiana Law

When one person's use of land interferes with another's use and enjoyment of a neighboring tract, courts seek the solution to the resulting controversy in that part of the law of torts called "nuisance" and characterize defendant's conduct as the maintenance of a nuisance if plaintiff is entitled to relief. A nuisance and a trespass are similar in that both interfere with the interests of an occupant of land. They differ, however, in that a trespass is usually a physical invasion of land complete in one instance, while a nuisance is ordinarily a continuing activity on a neighboring tract of land which produces such interferences as noise, smoke, or odors. The technique of resolving nuisance controversies differs greatly from that found in other areas of tort law. In the latter, the process of weighing the various interests involved in a given controversy has been transformed into the application of a body of relatively rigid rules, like those concerning intent, privilege, or negligence. In the field of nuisance, however, the factors considered appear on the surface and the courts weigh those factors against each other openly. For this reason, one finds no framework of fixed rules to refer to as the law of nuisance. One can only indicate the recurring factors considered by the courts in nuisance cases and suggest their relative weights in the balancing process which is the essence of deciding such cases.

The Magnitude of the Interference

One's right to the use and enjoyment of his land is of course limited by the rights of others to use and enjoy their own. On the basis of this broad generalization, courts refuse to consider an activity a nuisance unless the interference it creates is substantial in nature. To be deemed a nuisance, the defendant's conduct must be such as would interfere with an average man's