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NOTES

DEFENSES AVAILABLE TO PURCHASERS UNDER CONDITIONAL SALES CONTRACTS

In this age of increased emphasis of credit, many questions arise with respect to the rights of purchasers under conditional sales contracts where a promissory note, which was executed in conjunction with the contract, is later assigned to a finance company. Quite frequently, or so it would appear from the cases, the finance company attempts to raise the bar of holder in due course status in order to eliminate any defenses which might otherwise be applicable because of the conduct of the seller. This article will deal with various theories which the purchaser might use, under these circumstances, in order to attack either the negotiability of the note or the existence of holder in due course status. No particular attempt will be made to determine whether such theories are acceptable to a majority of the courts.

This problem requires a brief review as to the rights of an assignee as compared to the position of a holder in due course. Generally, the assignee of a chose in action holds it subject to those defenses or claims which might have been interposed against any predecessor in interest, except where the principle of estoppel prevents the assertion of those claims.[1] If the chose in action involves a negotiable instrument[2] and the assignee can be classified as a holder in due course,[3] most defenses and claims assertable against earlier holders of the instrument may not be interposed. Therefore, in order to assert a defense or claim against the holder of an instrument, the maker of the instrument must show either that the instrument is non-negotiable or that the assignee is not a holder in due course.

Although a consideration of every element affecting negotiability is beyond the scope of this article, several negotiability requirements are often involved in the conditional sales contract—promissory note situation. The promissory note is generally executed concurrently with the contract and may be either a separate instrument or attached to the contract. Quite frequently, the promissory note is an integral part of the document containing the contract, with only perforations or a dotted line separating the two instruments. If the note is physically attached to the contract, an initial question arises as to whether the note incorporates the contractual provisions. If the note states that it is "subject to" the contract or uses words of similar import, many courts have declared that the terms of the contract are incorporated.[4] Although a finding of incorporation would seem logical where the instruments appear on the same document, several courts have declared that the instruments are legally separate.[5] It should be noted that there is some authority for the proposition that where the note is subsequently detached from the contract, such action will avoid the note in the hands of a holder with notice of the detachment even though, the contract authorizes the detachment.[6] A note, otherwise negotiable, may be rendered non-negotiable by an incorporation of the terms of the contract.[7] In this regard, many cases have considered the effect of the so-called "insecurity clause." A typical "insecurity clause" provides that if the seller shall, at any time, deem the property or debt insecure, the entire amount is due and payable.[8] Such a clause, by making the maturity date dependent upon the whim or caprice of the holder, has

1. Universal Credit Co. v. Enyart, 231 Mo.App. 299, 98 S.W.2d 120 (1936); see the cases collected in 44 A.L.R.2d 189.
2. Wyo. Comp. Stat. § 13-287 (1957).
3. Wyo. Comp. Stat. § 13-337 (1957).
4. Klots Throwing Co. v. Manufacturers' Commercial Co., 170 Fed. 311, 179 Fed. 813 (2d Cir. 1910); Old Colony Trust Co. v. Stumpel, 126 Mis. Rep. 275, 213 N.Y.S. 536 (1926), affirmed in memorandum opinion, 247 N.Y. 538, 161 N.E. 173 (1928); ("identified with") Hamilton v. Vero Beach Reserve Mortgage Co., 107 Fla. 65, 144 So. 362 (1932); (*a reference to the particular contract involved*) General Motors Acceptance Corporation v. Garrard, 41 Idaho 151, 238 Pac. 524 (1925).
5. Morgan v. Mulcahey, 298 S.W. 242 (Mo. 1927); National City Bank v. Erskine & Sons, Inc., 158 Ohio St. 450, 110 N.E.2d 598 (1953).
6. See Steven v. Venema, 202 Mich. 232, 168 N.W. 531 (1918); but see People's Finance & Thrift Co. v. De Berry, 50 Wyo. 301, 62 P.2d 307 (1936).
7. (Note subsequently severed from contract) Van Nordheim v. Cornelius, 129 Neb. 719, 262 N.W. 832 (1935); Toledo Scale Co. v. Gogo, 186 Mich. 442, 152 N.W. 1046 (1915); see First Nat. Bank. v. Eames, 55 Idaho 628, 45 P.2d 795 (1935); also see First & Lumbermen's Nat. Bank v. Buchholz, 220 Minn. 97, 18 N.W.2d 771 (1945).
8. Old Colony Trust Co. v. Stumpel, 126 Mis. Rep. 275, 213 N.Y.S. 536 (1926), affirmed in memorandum opinion, 247 N.Y. 538, 161 N.E. 173 (1928).

been held to destroy negotiability.[9] The general rule in this instance would seem to be that a clause which gives the holder either an option upon the happening of a condition which cannot be established by objective evience, or an unconditional option to demand payment will restroy negotiability.[10] Negotiability may also be destroyed by requiring the maker of the note to perform acts other than the payment of money.[11] Where an instrument required the purchaser to keep the property free from taxes and satisfactorily insured in an amount equal to the unpaid balance, it was held to be non-negotiable.[12] It should be noted that these considerations are important only in those instances in which the offending provisions appear in the body of the note or the courts are willing to find that the note incorporates the contractual provisions.

If the instrument is negotiable, the purchaser cannot assert those defenses and claims which might have been available against prior holders of the note unless the present holder is not a holder in due course. A negotiable instrument which is complete and regular on its face must be taken before it is overdue, without notice of any dishonor, in good faith, for value, and with no notice (at the time of negotiation) of any infirmity in the instrument or defect in the title of the person holding it in order for the holder to be classified as a holder in due course.[13] Title is deemed defective within the meaning of the Negotiable Instruments Law in the following situations: if the instrument (or any signature thereto) was obtained by fraud, duress, force and fear, or other unlawful means; if it was obtained for an illegal consideration; or if it was negotiated in breach of faith; or under such circumstances as amount to a fraud.[14] In addition, failure of consideration and lack of consideration are apparently considered sufficient to constitute "defective title."[15] Although a holder is deemed *prima facie* to be a holder in due course, once the title of any person who has negotiated the instrument is shown to be "defective" the burden then shifts to the holder to prove that he is a holder in due course.[16] This burden of proof is very important since the maker need only show that a defense exists which would be assertable against an earlier holder of the instrument (such as fraud, failure of consideration, etc.) in order to place the risk of non-persuasion on the present holder. In this manner, the maker can then concenrate on rebutting the evidence offered by the finance company by showing irregularities in the instrument, notice of defects, or a lack of good faith on the part of the holder.

9. Murrel v. Exchange Bank, 168 Ark. 645, 271 S.W. 21 (1925); see Old Colony Trust Co. v. Stumpel, 126 Mis. Rep. 275, 213 N.Y.S. 536 (1926), affirmed in memorandum opinion, 247 N.Y. 538, 161 N.E. 173 (1928).
10. Britton, Bills and Notes, 107 (1943).
11. Wyo. Comp. Stat. § 13-291 (1957).
12. Bank of Commerce v. Waters, 215 S.C. 552, 56 S.E.2d 350 (1949); accord, Vancouver Nat. Bank v. Starr, 123 Wash. 58, 211 Pac. 746 (1923); see Motor Contract Co. v. Van Der Volgen, 162 Wash. 449, 298 Pac. 705 (1931).
13. Wyo. Comp. Stat. § 13-337 (1957).
14. Wyo. Comp. Stat. § 13-341 (1957).
15. Britton, Bills and Notes, 426 (1943).
16. Wyo. Comp. Stat. § 13-345 (1957).

The most serious difficulty arises with respect to determining whether the instrument was purchased in "good faith" by the finance company. The term "good faith" is a very nebulous one and, in the absence of obvious fraud, no single characteristic is actually controlling. Where the facts known to the finance company are sufficient to create the belief (or unavoidable inference) that an infirmity exists, it seems clear that the finance company cannot purchase the note in good faith.[17] Actual knowledge is not necessary and where a principal-agent relationship is established between the finance company and the dealer, the knowledge of the agent may be imputed to the finance company.[18] In addition, the conduct of the finance company may be such as to indicate the presence or lack of good faith on its part. For example, the "usual discount"[19] or payment of "full value"[20] will indicate good faith while payment of a grossly inadequate price for the commercial paper may raise the issue of bad faith.[21]

In determining the presence or absence of good faith on the part of the holder, courts have had the most trouble in evaluating the relationship between the seller and the finance company. Where a finance company becomes closely associated with the seller, either with respect to the transaction in question or the seller's business in general, some courts will refuse to permit the establishment of holder in due course status.[22] This result seems to be based on the theory that the finance company, under those circumstances, knows too much about the transaction behind the negotiable instrument to claim ignorance if a defense against the seller should appear. A finding of such a "close association" as will prevent a finance company from becoming a holder in due course generally results from the presence of several factors or characteristics. Supplying the dealer with contract and note forms has been held to indicate such an association and has the effect of making the finance company a party to the agreement from the beginning.[23] Many of the printed forms are completely filled out with respect to their assignment to the finance company and frequently refer to the proposed intention of the seller to assign the instrument to the supplying finance company.[24] Prior consultation with the seller as to the financing of a particular transaction may result in

17. Britton, Bills and Notes, 415 (1943).
18. United States v. Schaeffer, 33 F.Supp. 547 (D.Md., 1940); Associates Discount Corp. v. Goetzinger, 245 Iowa 326, 62 N.W.2d 191 (1954); Wright v. Krouskop, 56 Wyo. 226, 108 P.2d 262 (1940): (principal-agent relationship not established) People's Finance & Thrift Co. v. De Berry, 50 Wyo. 301, 62 P.2d 307 (1936). See Davis v. Commercial Credit Corp., 87 Ohio App. 311, 94 N.E.2d 710 (1950), in which knowledge of the district manager for the parent finance company of fraudulent dealing by the same dealer in another jurisdiction was apparently implied to a subsidiary finance company.
19. People's Finance & Thrift Co. v. De Berry, 50 Wyo. 301, 307, 62 P.d 307, 308 (1936).
20. General Credit Corp. v. First National Bank, 74 Wyo. 1, 19, 283 P.2d 1009, 1015 (1955).
21. See Painter v. Freije, 65 Ariz. 153, 176 P.2d 690 (1947).
22. Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W.2d 260 (1940); Commercial Credit Corp. v. Orange County Machine Works, 34 Cal.2d 766, 214 P.2d 819 (1950); Mutual Finance Co. v. Martin, ... Fla. ...., 63 So.2d 649, 44 A.L.R.2d 1 (1953).
23. Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W.2d 260 (1940).
24. See the form used in United States v. Troy-Parisian, Inc., 115 F.2d 224 (9th Cir. 1940).

barring the finance company from attaining holder in due course status.[25] The length of time between the execution of the note by the consumer and subsequent assignment to the finance company is frequently mentioned as bearing on the questions of good faith and prior knowledge of the transaction, by indicating the possibility of prior arrangements for financing between the parties.[26] At least one case has considered an indorsement "without recourse" as bearing on the good faith of the finance company.[27] Where the payee of the negotiable instrument was also a salesman for the manufacturer to whom the note was assigned, the Arkansas court found that the latter was not a holder in due course.[28] Similarly, where the president of an automobile agency was also the sole owner of the finance company to whom the note was transferred, the finance company was not a purchaser in good faith.[29] In addition, there is some authority for the proposition that where a salesman assists a dealer in making a sale and the note is assigned to his employer, the latter cannot claim holder in due course status so as to defeat claims or defenses arising from the sale.[30] Where both the contract and the note are assigned to a finance company, there is authority for finding that the finance company is charged with knowledge of any defects which might be shown by the contract (generally limited to such defenses as breach of warranty and a contractual right to return merchandise).[31]

Even where the maker is able to destroy negotiability or disprove the existence of holder in due course status, he may be estopped from asserting any defenses or claims against the holder of the instrument.[32] Many instruments contain clauses setting forth an agreement not to assert any defenses or claims againts an assignee of the note. While a conflict exists as to the validity of these clauses, it appears that a majority of the courts will refuse to give them effect.[33] While some of the cases on this point deal only with a contract, the principle would seem to be the same in those instances where the finance company is not a holder in due course. This result has been justified on the theory that such a clause is against public policy and constitutes an attempt to oust the courts from jurisdiction. It is contended that while a party can waive accrued rights, he cannot stipulate in advance that in the event of differences, he will deny himself the right

25. Commercial Credit Co. v. Orange County Machine Works, 34 Cal.2d 766, 214 P.2d 819 (1950).
26. Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W.2d 260 (1940).
27. Painter v. Freije, 65 Ariz. 153, 176 P.2d 690 (1947).
28. Bastion-Blession Co. v. Stroope, 203 Ark. 116, 155 S.W.2d 892 (1941).
29. ("The Biblical injunction to 'let not thy left hand know what thy right hand doeth', difficult as it is of practical achievement, fades into significance beside such a feat of Jeckyll and Hyde legerdemain"), Toms v. Nugent, 12 So.2d 713, 717 (La. 1943).
30. International Harvester Co. v. Newberry, 16 S.W.2d 871 (Tex. 1929).
31. (Note limited by the contract) Cooke v. Real Estate Trust Co., 180 Md. 133, 22 A.2d 554 (1941); accord, Industrial Loan & Trust Co. v. Bell, 300 Ill.App. 502, 21 N.E.2d 638 (1939); First & Lumbermen's Bank v. Buchholz, 220 Minn. 97, 18 N.W.2d 771 (1945).
32. Universal Credit Co. v. Enyart, 231 Mo.App. 299, 98 S.W.2d 120 (1936); see the cases collected in 44 A.L.R.2d 189.
33. 3 Jones, Chattel Mortgages and Conditional Sales, § 1257 (6th ed. 1933).

to resort to the courts for settlement.[34] Another case emphasizes the blanket nature of the particular waiver clause and the long, closely printed form of the agreement.[35] Waiver clauses have been declared invalid as to defenses based on fraud,[36] usury,[37] failure of consideration,[38] and breach of warranty.[39] Estoppel is a double edged sword and at least one court has refused to permit a finance company to take advantage of the waiver clause where it did not act in good faith in purchasing the contract.[40] In some cases, finance companies have attempted to obtain completion certificates (statements alleging complete performance of the contract) from the maker of the note, prior to purchasing the instrument.[41] This is done in an effort to estop the purchaser from later denying complete performance. Several courts have ignored these certificates when it appeared that the maker actually had a good defense.[42] In one case, the finance company apparently lost its holder in due course status because of an attempt to get such a certificate.[43] An attempt to determine whether there has been proper performance of the contract, by means of such a certificate, would seem to indicate good faith on the part of the finance company. However, the test of such good faith should depend on whether the purchaser, at the time the finance company obtained the certificate, had a reasonable opportunity to determine the existence of his claim or defense. Obviously, this test would eliminate those situations in which the contract is executed and assigned to the finance company on the same day.

The conflicts arising in this field of law can be explained on the basis of policy differences. Proponents of a strict construction of the Negotiable Instruments Law are vociferous in their demands that the free flow of commerce remain unimpeded, even though a few consumers may be harmed. A recent case involved a finance company which was organized solely for the purpoes of financing farm implements.[44] In order to obtain financing the dealers were required to sign a contract (in booklet form) containing such items as: an agreement to use only the forms of the finance company; a thirty day investigation period following acceptance, at the end of which time the finance company could require repurchase of the note by the dealer; a deduction from each note to establish a contingent reserve account; and an option on the part of the finance company to require the repurchase of any note containing "false representations."

34. Progressive Finance & Realty Co. v. Stempel, 231 Mo.App. 49, 95 S.W.2d 834 (1933); accord, San Francisco Securities Corp. v. Phoenix Motor Co., 25 Ariz. 531, 220 Pac. 229 (1923).
35. Quality Finance Company v. Hurley, ... Mass. ...., 148 N.E.2d 385 (1958).
36. Equipment Acceptance Corp. v. Arwood Can Mfg. Co., 117 F.2d 442 (6th Cir. 1941).
37. Motor Contract Co. v. Van Der Volgen, 162 Wash. 449, 298 Pac. 705 (1931).
38. Progressive Finance & Realty Co. v. Stempel, 231 Mo.App. 49, 95 S.W.2d 834 (1933).
39. San Francisco Securities Corp. v. Phoenix Motor Co., 25 Ariz. 531, 220 Pac. 229 (1923).
40. Thorp Finance Co. v. LeMire, 264 Wis. 220, 58 N.W.2d 641, 44 A.L.R.2d 189 (1953).
41. See People's Finance & Thrift Co. v. De Berry, 50 Wyo. 301, 62 P.2d 307 (1936).
42. State Nat. Bank v. Cantrell, 47 N.M. 389, 143 P.2d 592, 152 A.L.R. 1216 (1943); accord, Cooke v. Real Estate Trust Co., 180 Md. 133, 22 A.2d 554 (1941); see Griffin v. Baltimore Federal Savings & Loan Assn., 204 Md. 136, 102 A.2d 804 (1954).
43. Allied Bldg. Credits v. Ellis, 258 S.W.2d 165 (Tex. 1953).
44. Implement Credit Corp. v. Elsinger, 268 Wis. 143, 66 N.W. d 657 (1954).

The Wisconsin court held that unless the finance company actively participated in the transaction in question, it could not be said to have acted other than in "perfect good faith."[45] The Court based this result on the theory that if finance companies were unable to secure these many advantages, finance charges would be much higher and this would result in great harm to the purchasing public.

The advocates of a more liberal construction point to the historical basis for the Negotiable Instruments Law.[46] Where a negotiable instrument involves myriads of payees and indorsees in different locations, a strict construction of the Law is necessary in order to avoid impeding the free flow of commerce. A conditional sales contract combined with a promissory note, however, commonly involves only three parties: the purchaser (or consumer), the dealer, and the finance company. In most cases, the finance company is located in the same city as the other two parties and has an opportunity to investigate the good faith of the dealer (although it generally chooses to investigate the credit standing of the purchaser instead). It seems rather clear that a finance company is not relying on the intrinsic worth of the negotiable instrument where it insists on the use of its own forms, a re-purchase agreement, a contingent reserve account, an investigation of the purchaser, and a waiver of all defenses clause. It seems highly unlikely that the National Conference of Commissioners on Uniform State Laws had this type situation in mind when, in 1896, they proposed the basic outline for what is now the Negotiable Instruments Law. The roles of commercial paper and the finance company in modern business have progressed to an unbelievable extent since the time holder in due course status was first defined. To ignore this expanded relationship and its effect on modern business is to apply a completely outmoded standard to commercial situations.[47]

The Uniform Commercial Code, except in those instances in which terms are re-defined, makes very little change in the existing law.[48] The Code provides that where a buyer, as part of one transaction, signs both a negotiable instrument and a security instrument he makes an agreement that he will not assert against the holder any claim or defense he may have

45. Id. at 665.
46. (". . . In the yesterday of business the ordinary retail purchaser of goods had but one relationship to his merchant, that of credit extended on a personal, unsecured promise to pay. The average citizen, and particularly the financially unimportant, was no more likely to know the law of negotiable paper or the parol evidence rule, than the holding in Shelley's case. But almost overnight the picture changed, and today, from basinette to burial, the conditional sale contract is the constant companion of our citizenry . . .") Buffalo Industrial Bank v. De Marzio, 162 Misc. 742, 296 N.Y.S. 783, 785 (1937), reversed in 6 N.Y.S.2d 568 (1937) because the defendant failed to make an appearance after notice of appeal.
47. Id. at 786, in which it is stated: ". . . should we permit the finance company to isolate itself behind the fictional fence of the law merchant? . . . Should not the risk of the fraud and misrepresentation of the salesman be the risk of the business, rather than the risk of the unwary buyer? The finance company, being a de facto part of a great conditional sale commercial machine, should be no more allowed to escape from the effects of the misrepresentation of a salesman than is the merchant himself."
48. Uniform Commercial Code § 9-206(1).

against the seller. Except as to those defenses which may be asserted against a holder in due course, this agreement may be enforced by an assignee for value who takes in good faith and without notice of a claim or defense. It should be noted that this section is expressly made subject to any statute or decision which establishes a different rule for buyers of "consumer goods." "Consumer goods" are defined as those goods used, or bought for use, primarily for personal, family, or household purposes.[49] While the Code appears to recognize the need for a different rule in the case of "consumer goods," as opposed to those transactions between merchants, it expressly makes no effort to solve the basic problem of whether a finance company should be given the benefit of holder in due course status.[50]

In conclusion, it is submitted that the courts can best serve the interest of justice by adopting a reasonable standard to govern the determination of good faith on the part of finance companies in the conditional sales contract-promissory note situation. Where the claim of defense assertable against the dealer is groundless, the finance company should be able to prevail in a trial on the merits. If the claim is valid, however, the finance company should not be considered insulated from the claim where it has so involved itself with the business of the dealer that it may not, in the eyes of justice, be deemed a true holder in due course. As stated in a New York case, ". . . if any hardship is imposed by this rule, it is only the hardship that has always followed the refusal of the law to permit the divorce of honor from enterprise."[51]

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SALE WARRANTIES UNDER WYOMING LAW AND THE UNIFORM COMMERCIAL CODE

The sales warranties under the Uniform Commercial Code[1] are in many ways similar to the sales warranties contained in the Uniform Sales Act; however, there are significant differences that are worthwhile to note. This article will attempt to illustrate, by comparison, some of the more important differences between the two uniform acts. The comparison will actually be between existing Wyoming law and the Code since the Uniform Sales Act is law in Wyoming.[2]

There seems to be little change in the Code with respect to the express warranty, and the implied warranties of title, sale by sample and sale by

49. Uniform Commercial Code § 9-109(1).
50. See Uniform Commercial Code § 9-206, comment (2) (Uniform Laws Annoted 1958) in which it is stated: "This article takes no position on the controversial question whether a buyer of consumer goods may effectively waive defenses by contractual clause or by execution of a negotiable note."
51. Buffalo Industrial Bank v. De Marzio, supra note 46, at 786.

1. Hereinafter called the Code.
2. The warranty provisions of the Sales Act can be found in W.S. § 34-177 through § 34-181. The warranty provisions of the Code are found in § 2-312 through § 2-318.