Bills and Notes–1958 Tennessee Survey

S. B. Gilreath

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Express Provision Concerning Negotiability. Phelan v. Phelan is the only case which has been found on the subject of bills and notes decided during the survey period. It was a suit in equity on a note in the sum of $4,000 made on April 10, 1954, by R. E. Phelan and payable to W. O. Phelan on September 15, 1954. The note provided that it was "non-negotiable and non-transferable."

The payee, W. O. Phelan, filed a bill to recover a decree on this note against R. E. Phelan, the maker, who, in turn, filed an answer pleading as a set-off against the note a loan of $250 he had made complainant years before and also a car note in the sum of $1976 made by W. O. Phelan and payable to R. E. Phelan. The trial court allowed the set-off and rendered a decree in favor of complainant for the difference.

The two Phelan brothers were tenants in common of an 87-acre farm worth about $20,000 and were so estranged that they did not speak to each other. The estrangement seems to have arisen out of attempts to settle for improvements estimated at $10,000 which R. E. Phelan had put on the farm, as compared with $1000 in improvements made thereon by W. O. Phelan. Complainant, W. O. Phelan asked $10,000 for his undivided half interest. Through the efforts of a mutual friend, who was not called to testify, it was agreed that R. E. Phelan would pay $8,500 for W. O. Phelan's half interest in the farm, $4,500 cash and the remaining $4,000 to be evidenced by the note on which the original bill was filed.

At the time of the delivery of the deed, complainant and defendant met. The deed was delivered to the defendant who paid the complainant $4,500 and delivered the $4,000 note but defendant said nothing to complainant about the car note or the loan, both of which he expected to set off against the $4,000 note, and the statement "non-negotiable and non-transferable" was written in the note in order that it might be fixed and frozen in the hands of complainant and so be subject to the set-off. Defendant did not mention the automobile note of $1976 or the $250 loan because he knew that if he did say anything about them his brother would refuse to sell his half interest in the farm. Complainant contended that defendant's silence about the intended set-off constituted fraud.

The note is not published in the opinion and it cannot be told whether it otherwise was negotiable, but the court, without citing
authority, correctly treats the statement "non-negotiable and non-transferable" as destroying its negotiability for the purpose of determining the question of fraud. Does such provision destroy negotiability in an instrument otherwise negotiable? On this question the authorities are few. In *Equitable Insurance Co. v. Harvey* a provision reading: "It is understood and agreed that this note is not negotiable," did not prevent transfer to the payee's agent, which sued thereon to collect it.

The Uniform Act, section 1, provides that an instrument to be negotiable must conform to five requirements, and implies strongly that if the instrument does conform it is negotiable. Any provision declaring such instrument to be non-negotiable would be repugnant to the rest of the instrument. How would it be construed? Would the weight of reason and common sense favor negotiability or non-negotiability? In view of the meager authorities on the point, safety requires that the instrument be so made or drawn that it will not conform to the provisions of section 1 of the Uniform Act. For example, the words "order" or "bearer" always can be omitted, and then there can be no question of the instrument's non-negotiability. Of course, an express statement that the instrument is not negotiable also will not do any harm.

On the other hand, suppose that an instrument not otherwise negotiable contains a provision declaring itself to be negotiable, will this declaration make it so? In *Morgan Bros. v. Dayton Coal & Iron Co.* the bonds involved were not payable to order or bearer, but provided that the principal and interest evidenced by the indenture would be paid without regard to any equity between the company and the original or any intermediate holder thereof, and that the receipt of the registered holder of such principal and interest would be a good discharge to the company of the same.

After reviewing authorities, the court concludes its holding on the question by saying:

> It was entirely competent, in our judgment, for the parties to so contract, and, having done so, and these bonds having passed into the hands of innocent holders for value, such innocent holder will take the

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2. 98 Tenn. 636, 40 S.W. 1092 (1897).
5. This note is not negotiable," written on margin in red ink; *Herrick v. Edwards*, 106 Mo. App. 633, 81 S.W. 466 (1904), "Non-negotiable or transferable," written on margin, and on back; "This note is not transferable nor to be used as collateral without written consent of principal and indorsers. M. F. Marks."
7. 134 Tenn. 228, 183 S.W. 1019, 1025 (1916).
same free from any equities existing between the Company and the original holder, or any intermediate holder. It is immaterial, therefore, whether the bonds were technically negotiable or not, since this element of negotiability had been specifically contracted in the instrument.6

In this connection it is interesting to notice that the Supreme Court of Mississippi in Moore v. Vaughn7 held three notes to be non-negotiable because they were payable "to the order of . . . . . . . . . .," even though each note contained the statement, "This note is negotiable and payable without defalcation . . . . .," and the notes had been delivered to the person intended to be the payee and by him indorsed to plaintiff, who claimed as a holder in due course. In that case the plaintiff insisted that the provision, "This note is negotiable," rendered the notes negotiable notwithstanding the failure to name the payee. The court did not follow this contention, but used the following now often quoted language:

For illustration, if A undertakes to sell B a horse, and puts a label on a cow reading, "This is a horse," such label does not change the character, or name, of the animal. These words alone would not be sufficient to make an order note a bearer note. The contracts here to the effect that the notes were negotiable did not supply the requirements mandatorily fixed by the statute, and do not avail to render them complete and regular on their face, so that Moore can now be declared to be a holder in due course.8

6. The supreme court wisely stated that it is "immaterial, therefore, whether the bonds were technically negotiable or not." 183 S.W. at 1025. In 1 DANIELS, NEGOTIABLE INSTRUMENTS § 106 (6th ed. 1913) it is said that under the N.I.L. the instrument must be payable to order or bearer, and is not negotiable if it is not so payable. To the same effect is the 7th Edition, § 122; Gilley v. Harrell, 118 Tenn. 115, 101 S.W. 424 (1907); Ahrens & Ott Mfg. Co. v. Moore & Sons, 131 Tenn. 115, 174 S.W. 270 (1915) and Weems v. Neblett, 139 Tenn. 655, 202 S.W. 930 (1918), all hold that instruments, not payable to order or bearer, are not negotiable under the N.I.L.

"Since an instrument to be negotiable must comply with certain statutory requirements, a non-negotiable instrument cannot be made negotiable by contract. There is authority for the view, however, that instruments not otherwise negotiable may become negotiable by estoppel or contract." 1 AM. JUR. BILLS AND NOTES § 45 (1937). See also id. § 78, and annot., 79, A.L.R. 29 (1932); 10 C.J.S. BILLS AND NOTES § 123.


"Conditional contracts of sale are non-negotiable instruments in this state. . . . Parties may not impart the character of negotiability to any other writing not of itself a negotiable instrument under the general law merchant or by the statutes of the state." American Nat'l. Bank v. Sommerville, 191 Cal. 364, 216 Pac. 376 (1923). See also Beute, Negotiability By Contract, 28 ILL. L. REV. 205 (1933); BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 214 (7th ed. 1948); Manhattan Co. v. Morgan, 242 N.Y. 38, 150 N.E. 594 (1925); Motor Contract Co. v. Van Der Volgen, 162 Wash. 449, 298 Pac. 705 (1931).

7. 167 Miss. 758, 150 So. 372 (1933). See also Rich v. Starbuck, 51 Ind. 87 (1875).

In view of the condition of the cases and the mandatory language of the negotiable instruments statute, two conclusions can be reached from the draftsman's standpoint: (1) In drawing a negotiable instrument, conform to the statute; in drawing a non-negotiable instrument, do not conform to the statute. (2) Under the holding in *Morgan Bros. v. Dayton Coal & Iron Co.*, it is possible for the parties to incorporate an element of negotiability into a non-negotiable contract, provided the thing incorporated (usually the waiver of equities) does not contravene the law or public policy. It seems that these are the only two things which can be nailed down. Also, it is hoped that the collection of authorities may prove helpful to the lawyer who may have to prosecute or defend a suit involving these questions.

**Presumption That Payee of Note Not Indebted to Maker.** The execution of a promissory note raises a disputable presumption that the payee is not indebted to the maker. This presumption is applicable in a suit by the payee against the maker wherein the maker sets up a claim against the payee which the maker alleges was in existence at the time the note was executed. In *Robertson v. Branch*, the Tennessee Supreme Court said:

> We regard it as a well-settled principle that the execution of a note under seal is prima facie evidence of the settlement of all pre-existing accounts between the parties and that it throws the onus of proof on the party who claims otherwise.

The rule has been held to apply (1) to a suit between the parties to the note, in which the maker sets up a claim against the payee which he alleges was in existence at the time the note was executed; (2) where suit is brought on a claim and the defendant introduces in evidence a note executed by the plaintiff to him after the time the claim is alleged to have accrued; (3) where a suit is brought by a personal representative and the defendant introduces in evidence a note executed by plaintiff's decedent while the alleged claim was in existence; (4) where a suit is brought against a personal representative, and he introduces in evidence a note executed by the plaintiff to his decedent.

The reason for the presumption is that the giving of the note is looked upon as the result of an accounting, and effects a settlement of all demands between the parties; that it is too highly improbable that a person would execute a note in favor of one who owes him money. Of course, as stated before, the presumption is disputable.

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9. 134 Tenn. 223, 183 S.W. 1019 (1916).
10. 36 Tenn. 506 (1856).
The court of appeals holds that this presumption of settlement continued as evidence in the case throughout the trial and was to be weighed along with all the other evidence in the case and that the defendant, R. E. Phelan, the burden being on him to rebut the presumption, had not done so.

The court also holds that the defendant R. E. Phelan, by accepting the deed to the one-half interest in the farm and obtaining also a release of complainant's claim to a half interest in the accrued rents along with a release in favor of the defendant of complainant's right to redeem another tract of land, had estopped himself to assert the two items by set-off. The decree below was reversed and a decree entered in favor of the complainant in accordance with prayers of the original bill.