Vanderbilt Law Review

Volume 10
Issue 5 *Issue 5 - A Symposium on Law and Christianity*

Article 8

8-1957

Bills and Notes -- 1957 Tennessee Survey

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BILLS AND NOTES—1957 TENNESSEE SURVEY

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Effect of Usury in Execution of Negotiable Instrument—Burden of Proving Holder in Due Course Where Maker of Instrument Is Suing the Holder to Cancel.

In *Braswell v. Tindall*,[1] the highest tribunal in Tennessee was called upon to determine the rights of the maker of a negotiable note (a) to recover usurious interest already paid from a defendant-holder who became the holder of the note after it had been negotiated by the payee and (b) to enjoin defendant-holder from collecting the residue of the note, which was alleged to be usurious. In essence, the holder defended on the grounds that there was no usury and if there was usury it was between the maker and the payee and, therefore, he (the holder) was not affected by the usury for the reason that he was a holder of the note in due course.

Plaintiff-maker executed the $2,500 note in question, payable to bearer, and delivered it to Jones. As consideration for the note maker received Jones' own check for $200 and another of maker's notes, belonging to defendant, Tindall, for $1,357, including principal and interest. The $2,500 note bore interest from date. Jones transferred the note in question and the defendant, Tindall, became the holder of it. It is not clear whether Jones negotiated the note directly to the defendant-holder or whether he negotiated the note to some one else who negotiated it to the defendant.

In the maker's suit against the holder of the note it is claimed that the interest was usurious to the extent of approximately $975. The maker, as plaintiff, sued to recover from the holder that part of the interest already paid which was said to be usurious, and he also sought to enjoin the collection of the unpaid residue of the interest which also was allegedly usurious. The opinion does not make it clear whether the usurious interest was paid to defendant-holder, or to the payee, Jones, although there are suggestions in the opinion that it was paid to defendant.

Plaintiff-maker put in evidence that showed the entire nature of the execution of the note in question by plaintiff to Jones. This testimony would, of course, show the usurious nature of the transaction. Defendant-holder did not testify nor did he offer any evidence to prove that he was a holder in due course. He rested his contention that he was a holder in due course solely on section 59 of the Negotiable In-

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1. 294 S.W.2d 685 (Tenn. 1956).

struments Law, adopted in Tennessee,[2] which provides that every holder of a negotiable instrument obtained before maturity is deemed prima facie to be a holder in due course. That same section of the Negotiable Instruments Law also provides that

> [W]hen 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 other person under whom he claims acquired the title is a holder in due course.

The chancellor who tried the suit held that usury was not a defect in title within the meaning of this provision of the Negotiable Instruments Law and hence the presumption that defendant was a holder in due course remained, even though the plaintiff-maker had proved usury in the execution of the note to Jones. Consequently, the chancellor refused any relief to plaintiff.

The court of appeals reversed the chancellor and rendered judgment for plaintiff in the amount of the allegedly usurious interest and enjoined the collection of the unpaid balance of the note. The court of appeals was of the opinion that the defendant-holder had full knowledge of the whole transaction and knew of its usurious nature from the time the note was executed by plaintiff to Jones.

On appeal by the defendant-holder (Tindall) to the Supreme Court of Tennessee, the court wrote an opinion denying certiorari and also wrote an opinion in denying a petition to rehear.

The Supreme Court held that the plaintiff-maker had proved usury, which constituted a defect in the title of the note within the purview of section 55 of the Negotiable Instruments Law and that this showing of a defective title cast upon the defendant-holder the burden of proving that he or some person under whom he claims acquired the the title as holder in due course.[3] The court then concluded that since the defendant-holder did not testify nor offer any evidence he failed completely to show that he was a holder in due course. Having reached the conclusion that the defendant-holder was not a holder in due course, the Supreme Court held that the court of appeals correctly entered judgment against the defendant-holder (Tindall) for the amount of the usury and that the court of appeals correctly enjoined any further collection of the usurious residue of the note.

Presumably there was usury in connection with this $2,500 note, which bore interest from date, and for which note the plaintiff-maker received value of only approximately $1,577.[4] Tennessee law author-

2. TENN. CODE ANN. § 47-159 (1956).
3. NEGOTIABLE INSTRUMENTS LAW § 59; TENN. CODE ANN. § 47-159 (1956).
4. The relevant Tennessee statute defines usury as follows: "The amount of said compensation (interest) shall be at the rate of six dollars ($6.00) for the use of one hundred dollars ($100) for one (1) year; and every excess over

izes the recovery of usury by the party from whom it was taken,[5] if suit is started within two years from date of payment of the debt upon which the claim for usury is based.[6] There may be a recovery of the usurious interest in Tennessee even though the debtor paid the usury voluntarily.[7] Also, where a debtor is sued under Tennessee law, a statute provides that he may avoid the excess over legal interest by a plea setting forth the amount of usury.[8] If usury does not appear on the face of a contract, the contract is said in Tennessee to be valid to the extent of the money loaned, and the lawful interest therefor, and voidable only as to the usurious excess.[9] Moreover, under Tennessee law the bona fide holder of a promissory note, without notice of usury, apparently is not affected by the usury between the original parties.[10] With those propositions of Tennessee law set forth, let us now examine further the controversy in *Braswell v. Tindall,* the case at hand.

In *Braswell v. Tindall,* the defendant-holder denied that the transaction was usurious, even as between the plaintiff-maker and Jones to whom the note was issued; and defendant further undertook to show that he was a holder in due course of the note and thus not affected by any usury that may have existed between the original parties to the note. To establish his position as a holder in due course, defendant relied solely on the presumption of section 59 of the Negotiable Instruments Law,[11] which provides that when it is shown that a person is the holder of a note there arises a prima facie presumption that he is a holder in due course. But, as we have already seen, that section of the Negotiable Instruments Law further provides that when it is shown that the title of a person who negotiated an instrument is defective the burden is on the holder to prove that he or some person under whom he claims acquired the title as a holder in due course. Defendant-holder contended, however, that usury is not a defect in title within the purview of this section.

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that rate is usury." TENN. CODE ANN. § 47-1604 (1956). The following cases, where the transaction followed a pattern similar to that employed in the case at hand, held the transaction usurious: Bochicchio v. Petrocelli, 126 Conn. 336, 11 A.2d 356 (1940); Levenson v. Cohen, 250 Mich. 31, 229 N.W. 433 (1930); Cattle v. Haddox, 14 Neb. 527, 16 N.W. 841 (1883); Bennett v. Hadsell, 23 N.J.Eq. 174 (Ch. 1872); Hopmans v. Teuscher, 131 Misc. 272, 227 N.Y.Supp. 427 (Sup. Ct. 1928); Brown v. Skotland, 12 N.D. 445, 97 N.W. 543 (1903); Wolfe v. Stevenson, 129 Okla. 148, 264 Pac. 182 (1928); Temple Trust Co. v. Moore, 133 Tex. 429, 126 S.W.2d 949 (1939). For a treatment of the usurious nature of charges, in addition to interest, permitted by small loan acts, including that of Tennessee, see Annot., 143 A.L.R. 1323 (1943).

5. TENN. CODE ANN. § 47-1618 (1956).
6. TENN. CODE ANN. § 47-1618 (1956).
7. See Scheid v. Family Loan Co., 163 Tenn. 611, 613, 45 S.W.2d 54 (1932).
8. TENN. CODE ANN. § 47-1612 (1956).
9. See Deaton v. Vise, 186 Tenn. 364, 376, 210 S.W.2d 665, 670 (1948).
10. Bradshaw v. VanValkenburg, 97 Tenn. 316, 37 S.W. 88 (1896) (decided before the adoption of the Negotiable Instruments Law in Tennessee).
11. TENN. CODE ANN. § 47-159 (1956).

At the outset, then, there arises a question whether usury is a defect in title. Section 55 of the Negotiable Instruments Law provides:

> The title of a person who negotiates an instrument is defective within the meaning of this law when he obtained the instrument, or any signature, thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to fraud.[12]

Without laboring this point, it is enough to say that the authorities are agreed that usury is an illegal consideration and therefore constitutes a defect in title.[13]

Since usury constitutes a defect in title under section 59 of the Negotiable Instruments Law, which defect apparently will be purged under the Tennessee law if the note gets into the hands of a holder in due course, there arises some questions as to the burden of proof in connection with establishing whether the holder is a holder in due course. *Braswell v. Tindall* is somewhat unusual in that the maker of the note is seeking by his affirmative action, as plaintiff, to dislodge the defendant-holder from his position as a holder in due course so that the defect in title will not be cut off. This, of course, is a necessary step which plaintiff must take in order to recover the usurious interest paid and in order to enjoin the collection of the usurious residue of the interest. Generally, of course, such defects of title are interposed by way of defense by the injured party when he is sued on the instrument by the holder. In order to free an instrument of a defective title, section 59 of the Negotiable Instruments Law simply provides that when it is shown that the title is defective the burden is on the holder to prove that he or some person under whom he claims acquired the title as a holder in due course. This statutory provision makes no distinction—as to who must carry the burden of proving a holder in due course—between the situation in which the holder is a plaintiff suing on the instrument and the situation in which the person who executed the instrument is taking affirmative action as plaintiff against the holder as a defendant.

Where the party who executed the instrument with a defective title is taking the affirmative action against a holder deriving title from the payee who created the defective title within the meaning of section 59, as in the case at hand, essentially the same rules with respect to the burden of proving that one is a holder in due course, so as to cut off

12. TENN. CODE ANN. § 47-155 (1956).

13. Patterson v. Wyman, 142 Minn. 70, 170 N.W. 928 (1919) (Negotiable Instruments Law not cited); Kelly v. Industrial Operating Co., 329 Mo. 629, 46 S.W.2d 181 (1932); State v. Emery, 73 Okla. 36, 174 Pac. 770 (1918); Keene v. Behan, 40 Wash. 505, 82 Pac. 884 (1905); see 8 AM. JUR., *Bills and Notes* § 1028 (1937).

the defect in title, seem to apply as where the holder is the plaintiff.[14] Likewise, section 59 in dealing with the "burden of proving" a holder in due course does not make it clear whether it is referring to the burden of "coming forward with the evidence" or whether it means the burden of establishing the facts by a preponderance of the evidence. With this ambiguity in the statute the courts, as might be expected, are in conflict as to the various meanings and applications of the "burden of proof" under section 59. The burden of "coming forward with the evidence" is often confused in the opinions with that of establishing the facts by a preponderance of the evidence.[15] In applying that part of section 59 dealing with the burden of proof where the title of the instrument has been proved defective, perhaps the majority of cases cast both burdens on the holder of the instrument who is seeking to prove that he is a holder in due course.[16] Thus the majority of cases hold that the "burden of proof," as used in section 59, means burden of persuasion, both where the holder is suing on the instrument and where the party who executed the instrument seeks, as plaintiff, affirmative relief based on a defect in title.[17] While not many cases have been found in which the party who executed the instrument with a defective title was suing as plaintiff to be relieved of liability on the instrument, which had been negotiated by the payee to the defendant-holder, nevertheless all of these opinions do make it clear that the defendant-holder has the burden of proving that he is a holder in due course so as to cut off the defect in title created by the payee's conduct.[18]

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14. See 33 HARV. L. REV. 274 (1919).

15. See 32 HARV. L. REV. 729 (1919). For an analysis of these conflicting views as applied to § 59 of the Negotiable Instruments Law, see BRITTON, BILLS AND NOTES 432-40 (1943); BRANNON, NEGOTIABLE INSTRUMENTS LAW 859-84 (7th ed., Beutel 1948); Honigman, *Proof of Good Faith*, 23 MICH. L. REV. 870 (1925); Note, 80 U. PA. L. REV. 717 (1932); Annot., 152 A.L.R. 1331 (1944).

16. See BRITTON, BILLS AND NOTES § 104, especially pp. 432-33 (1943).

17. See 33 HARV. L. REV. 729 (1919).

18. Not many cases have been found where the plaintiff was using usury as a defective title to obtain relief against the defendant-holder, but the rules applying to other defects in title would seem clearly to apply to the defect of usury. In Davenport v. Kendrick, 148 Va. 479, 139 S.E. 295 (1927) the maker of a note, as plaintiff, sued to enjoin a mortgage sale and to purge the note of usury. The court held that the defendant-holder had the burden of proving that he was a holder in due course, in order to cut off the usury. He did carry the burden in that case. In Miller v. Commercial State Sav. Bank, 227 Mich. 316, 198 N.W. 996 (1924), plaintiff-maker sued to set aside a transaction on grounds of fraud and to restrain the holder-bank from enforcing a note in connection with the transaction and transferred by payee to holder-bank. The court held that plaintiff having established fraud, the burden was upon defendant-holder to establish that it was a bona fide purchaser in due course for value, without notice of its infirmities. In Lundean v. Hamilton, 184 Iowa 907, 169 N.W. 208 (1918), mortgagor sued to cancel a note and mortgage obtained by the payee's fraud and transferred for value to the holder-bank. The court held that when fraud was established, constituting a defective title, the defendant-holder then had the burden of proving it was a holder in due course by a preponderance of the evidence. In a suit to cancel a mortgage

The burden of establishing a defective title to the note in the case at hand would seem clearly to rest on the plaintiff-maker. If he failed to sustain that burden, then no burden rested on the defendant-holder to support by evidence his prima facie case that he was a holder in due course.[19] The court of appeals and the Supreme Court were both satisfied that plaintiff did successfully carry the burden of establishing a defect in title by showing clearly that the transaction was usurious. Moreover, the trial court apparently was satisfied that usury was proved but denied relief to the plaintiff because it erroneously held that usury did not constitute a defect in title. Since the plaintiff-maker established a defective title by proving usury, under section 59 of the Negotiable Instruments Law the defendant-holder then had the burden of proving that he was a holder in due course in order to escape the consequences of the defect in title.[20]

Since the plaintiff-maker proved a defect in defendant-holder's title to the note in question and defendant offered no evidence to show that he was a holder in due course, it would appear that the Supreme Court quite properly held that the defendant was dislodged from his favored position as a presumed holder in due course, even though the maker was attacking the note as a party plaintiff, rather than defending the suit against a holder of the note.

In requiring the holder of the instrument, although a defendant, to prove by a preponderance of the evidence that he was a holder in due course before the defect in title would be purged, the Tennessee Supreme Court in *Braswell v. Tindall* seems wisely to have taken a position in conformity with the view of a majority of the courts in construing section 59 of the Negotiable Instruments Law, as applied to situations in which the holder, as plaintiff, is seeking to prove that he is a holder in due course.[21] The minority view, on the other hand,

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note in the hands of a holder who took from the payee, on the ground that the maker was insane, it was held that once the plaintiff (curatrix of maker) had established the infirmity, then under § 59 of the Negotiable Instruments Law the defendant-holder had the burden of proving his own good faith. Smith v. Burt, 46 F.2d 336 (W.D. La. 1930). In Young v. Harris-Cortner Co., 152 Tenn. 34, 268 S.W. 1120 (1925), defendant-holder of warehouse receipts was required to carry the burden of showing he was a holder in due course where it was shown that the receipts were obtained by fraud.

19. See Beacon Trust Co. v. Ryder, 273 Mass. 573, 174 N.E. 725 (1931) (where the maker was defendant).

20. See note 19 *supra*. For additional cases dealing generally with the burden of proving that one is a holder in due course, see Title Guaranty Co. v. Barone, 319 Pa. 499, 181 Atl. 765 (1935); Glendo State Bank v. Abbott, 30 Wyo. 98, 216 Pac. 700 (1923); Third Nat'l Bank v. Keathley, 35 Tenn. App. 82, 95-96, 242 S.W.2d 760, 766 (1951).

21. See 8 AM. JUR., *Bills and Notes* § 1022 (1937); BRANNAN, NEGOTIABLE INSTRUMENTS LAW 876-79 (7th ed., Beutel 1948); BRITTON, BILLS AND NOTES 433-34 (1943). See Annot., 152 A.L.R. 1331, 1336 (1944), for collections of cases. Tennessee also seems to be of the majority persuasion. Equipment Acceptance Corp. v. Arwood Can Mfg. Co., 117 F.2d 442 (6th Cir. 1941) (applying Tennessee law); see Fox v. Cortner, 145 Tenn. 482, 496-97, 239 S.W.

takes the position that the "burden of proof," as used in section 59, means only the burden of producing evidence. Under this view, when the holder of the instrument has produced enough evidence of his due course holding to prevent a directed verdict against him, the burden of persuasion shifts to the other party to prove that the holder is not a holder in due course.[22]

The majority view appears to be preferable to the minority. While the majority view requires the bona fide purchaser to convince the trier of fact that he is such, this burden of proof should not be difficult to sustain, if the holder did in fact take in good faith. The majority rule thus puts the burden of proof upon the only party who knows the facts surrounding his taking of the instrument. As Mr. Britton, a leading authority, puts it:

> But many a pretended bona fide purchaser, the unscrupulous discounter who always stands ready to take the ill-gotten paper obtained by the fraudulent payee, will be caught in his own web by the majority rule, whereas, under the minority rule, many such purchasers will win, not because they are bona fide, but because the defendant [plaintiff in case at hand] will not be able to get the evidence necessary to show that plaintiff's [defendant in case at hand] cultivated innocence was but a mask.[23]

Having reached the conclusion that the defendant-holder was not a holder in due course in the present case, there still remains the question whether plaintiff-maker can recover the usurious interest from the defendant-holder, as well as enjoin the collection of the unpaid usurious residue of the note. Clearly, if maker were sued on the note by holder (Tindall), maker would have a defense as to the excess, over legal interest, since this holder is not a holder in due course.[24]

1069 (1922); Third Nat'l Bank v. Keathley, 35 Tenn. App. 82, 96, 242 S.W.2d 760, 766 (1951).

22. "Evidence that plaintiff purchased the trade acceptance sued on for value before maturity, and in the usual course of business, shows *prima facie* that he was a bona fide purchaser for value and shifted to the defendant the burden of proving the contrary." (Emphasis added.) King v. Steward, 265 S.W. 78, 79 (Ark. 1924). For other cases adopting the minority view see Sewell v. Nolen Bank, 204 Ala. 93, 85 So. 375 (1920); Blochman Commercial & Sav. Bank v. Moretti, 177 Cal. 256, 170 Pac. 419 (1918); Stevens v. Perce, 79 Okla. 290, 193 Pac. 417 (1920); Jackes-Evans Mfg. Co. v. Goss, 254 S.W. 320 (Tex. Civ. App. 1923); see BRITTON, BILLS AND NOTES 436-37 (1943); Annot. 152 A.L.R. 1331, 1338 (1944); BRANNAN, NEGOTIABLE INSTRUMENTS LAW 879-82, (7th ed., Beutel, 1948), for other cases.

23. BRITTON, BILLS AND NOTES 437-38 (1943).

24. TENN. CODE ANN. § 47-1612 (1956). There are several views on the question of the extent to which usury may constitute a defense. One line of authority holds the instrument void as to both principal and interest, being a good defense even against a holder in due course. Other courts declare the instrument void only as to the interest. A third view declares the transaction void only as to the excess interest over the legal rate. In Tennessee an instrument which is usurious on its face is said to be void, but where the usury does not appear on the face of the instrument it may be pleaded as a defense only as to that part of the contract. See Deaton v. Vise, 186 Tenn. 364, 376, 210 S.W.2d 665, 670 (1948); Bank v. Walter, 104 Tenn. 11, 17, 55 S.W. 301, 303

Since maker would have had a defense to this holder's claim for the amount involved, all of which appears to be usurious, it is difficult to see why maker should not be able to recover from this holder the usurious interest, if it was already paid to holder, and enjoin the holder from collecting any unpaid usurious interest in connection with this note. Since it is a policy of the courts to suppress usury, usury is often as much a matter of affirmative relief as it is a ground of defense.[25] Payments of usurious interest are thus regarded as made under the constraint of a formal, although illegal, contract obtained by taking advantage of the necessities of the borrower, and such payments are, therefore, excepted from the ordinary rule that one voluntarily paying money under an illegal contract cannot maintain an action to recover it.[26] Some courts, however, do deny recovery of usury allegedly paid for the reasons that the payor and payee are said to be in pari delicto, and the payment is treated as voluntary since the claim was illegal and there was no liability to pay in the first instance.[27] However, the public policy of Tennessee as expressed in both statutory and case law permits the recovery of usury.[28] Hence, in the writer's opinion the Supreme Court of Tennessee quite properly granted plaintiff-maker the requested relief from the usurious transaction.

(1900). However, in Tennessee a bona fide holder, without notice, of a promissory note is not affected by the usury between the original parties. Bradshaw v. VanValkenburg, 97 Tenn. 316, 37 S.W. 88 (1896) (decided before the adoption of the Negotiable Instruments Law in Tennessee). This view is followed by a substantial number of courts. For comprehensive coverage of the various views relative to the defense of usury, mentioned above, see 8 AM. JUR., *Bills and Notes* § 582 (1937); BRITTON, BILLS AND NOTES, § 551 (1943); OGDEN, NEGOTIABLE INSTRUMENTS § 177 (5th ed. 1947); Annots. 95 A.L.R. 735 (1935), 5 A.L.R. 1447 (1920). For another treatment of the various types of usury laws, see Weinstein, *When a Bill or a Note Represents an Usurious Contract in Louisiana,* 5 TUL. L. REV. 211, 218-22 (1930). Also, see Beutel, *The Interepretation of the N.I.L. and Statutes Declaring Instruments Void,* 83 U. PA. L. REV. 744 (1935).

25. See 55 AM. JUR., *Usury* §§ 101, 111 (1946).

26. *Id.* § 111.

27. *Id.* § 112.

28. TENN. CODE ANN. § 47-1617 (1956); see Scheid v. Family Loan Co., 163 Tenn. 611, 613, 45 S.W.2d 54 (1932).