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BILLS AND NOTES

PAUL J. HARTMAN*

The Parol Evidence Rule as Applied to Bills and Notes. The Tennessee Supreme Court case of *Lazarov v. Klyce*[1] presented the problem of when an agent who has signed a negotiable instrument can use parol evidence to exonerate himself from personal liability on the instrument at the suit of the payee. The payee of a note sued the defendant, Arnold Klyce, to hold him individually liable on the note of a corporation of which defendant was an officer. The defense was that the note was an obligation of the corporation, that defendant signed as an officer of the corporation and that he incurred no personal liability on the instrument. The signatory part of the note was as follows:

"Independent Tool & Machine Co.
"By J. W. Clements
"Arnold Klyce"

Over the objection that defendant's oral proof showing his representative capacity violated the parol evidence rule, defendant was permitted to prove that he signed only as an agent; and the jury found a verdict for defendant. The chancellor set the verdict aside on the ground that the note was clear and unambiguous and that, therefore, parol evidence was improperly admitted. The Court of Appeals reversed on the ground that there was ambiguity surrounding the manner in which defendant's signature appeared on the note and that parol evidence was properly admitted to clear up the ambiguity. The Supreme Court reversed the Court of Appeals and affirmed the decree of the chancellor.

The crucial question was whether the signature of Arnold Klyce on the note was ambiguous so that parol evidence was admissible to show that he signed as an agent of the corporation and that he intended not to bind himself personally. A well-recognized authority states the majority rule under the Negotiable Instruments Act, adopted in all forty-eight states, to be that, although an agent nowhere on the instrument discloses the fact that he is acting in a representative capacity, nevertheless he can use parol evidence in an effort to escape personal liability, if the instrument discloses the name of some third party who might or might not be his principal.[2] It is rather clear that this rule

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1. 255 S.W.2d 11 (Tenn. 1953). See the comment on this case in the Interpretation Section of the Contracts article and the Evidence section of the Procedure and Evidence article.

2. BRITTON, BILLS AND NOTES 782-88 (1943). There are numerous cases supporting this view.

Across the left hand end of a check was printed: "State Street Grocery Co., Inc., 161 State St., Hartford, Conn." It was signed: "M. Gross." The payee

would have permitted the defendant in the case at hand to introduce parol evidence to show that he did not bind himself personally. The Court of Appeals so held, but the Supreme Court, in refusing to admit the parol evidence, followed a strict, minority view of personal liability of an authorized agent who, in some form on the instrument, has disclosed his principal's name and has given some intimation of the fact of his agency. This view holds that the agent cannot be exonerated from personal liability by use of parol evidence, even though there is disclosed somewhere on the instrument the name of another person who might or might not be the principal.[3]

The factor that causes difficulty in the instant type of case is the doubt as to whether the signer intended to sign as an agent or as a surety for his principal. Under the majority view, such doubts are resolved in favor of the signer. Having due regard for the varied, if not careless, forms adopted by persons who really intend to bind their principals and not themselves, a leading authority in the field thinks the majority rule preferable to the strict minority, for normally the majority's construction effectuates the intention of both parties.[4] Also, the minority rule often gives the holder a more favorable position than

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sued Gross as drawer of the check to hold him personally liable. It was held that parol evidence was admissible to show that Gross signed only as an agent of the State Street Grocery, even though he had not added words to indicate any representative capacity, and judgment for plaintiff against Gross individually was reversed. Austin, Nichols & Co. v. Gross, 98 Conn. 782, 120 Atl. 596 (1923).

A note was signed:

"Carlton Auto Supplies Co., Inc.
"Sam Lichtenstein,
"Wm. Lee, Treas."

It was held error to direct a verdict against Lichtenstein personally. Parol evidence tending to show that he signed as president of the corporation was wrongfully excluded by the trial court. Hoffstaedter v. Lichtenstein, 203 App. Div. 494, 196 N.Y. Supp. 577 (1st Dep't 1922).

A note was signed:

"Northway Trailer Car Company,
"Kate Gleason."

It was reversible error to direct a verdict for plaintiff, payee, against Gleason personally. The trial court should have permitted Gleason to show that she signed only as treasurer of the corporation. Central Bank of Rochester v. Gleason, 206 App. Div. 28, 200 N.Y. Supp. 384 (4th Dep't 1923).

For additional cases permitting the agent to use parol evidence to show that he signed in a representative capacity, and not to bind himself personally, where the instrument disclosed the name of a third party who could have been the principal, although nowhere on the instrument was it disclosed that the agent did sign in a representative capacity, see Fricke v. Belz, 237 Mo. App. 861, 177 S.W.2d 702 (1944); Germania National Bank v. Mariner, 129 Wis. 544, 109 N.W. 574 (1906). See also 1 MECHEM, AGENCY § 1162 (2d ed. 1914); MECHEM, OUTLINES OF AGENCY § 316 (4th ed. 1952).

3. BRITTON, BILLS AND NOTES 788-93 (1943). One of the cases relied on by the Tennessee Court as directly in point is the Virginia case of Coal River Collieries v. Eureka Coal & Wood Co., 144 Va. 263, 132 S.E. 337 (1926). But in the later Virginia case of Baach v. Bank of Pocahontas, 157 Va. 274, 160 S.E. 68 (1931), the court may have sapped somewhat the vitality of the *Eureka Coal* case.

4. BRITTON, BILLS AND NOTES 791 (1943).

he deserves. If affairs have gone badly with the principal, the minority approach may enable the payee to collect from the agent, although the payee would never have thought of it at the time the agent signed the instrument.

When the plaintiff is a holder in due course, perhaps parol testimony should be more narrowly restricted to the clearing up of ambiguities than when he is the payee. The *Lazarov* case involved a suit by the payee, however, and not an action by a holder in due course.

Power of Court to Reduce Attorney's Fee Stipulated in Bills and Notes. The Tennessee Court of Appeals case of *Young v. Jones*[5] involved, among other things, the question whether the court can control the amount that the holder of a note can collect as an attorney's fee from the maker of the note, where the note expressly stipulates that the maker will pay a fixed percentage by way of an attorney's fee. The note in question contained the customary promise to pay a ten percent attorney's fee. The trial court denied the holder recovery of the fee called for in the note, but the Court of Appeals reversed and awarded the holder the full ten percent. Although it is not clear, the opinion suggested that the maker had taken the position, among others, that the full ten percent should not be allowed and that the court should determine what was a reasonable attorney's fee. Rejecting this argument, the Court of Appeals held that the promise to pay ten percent was a "constituent part of the obligation of the note contract and the court has no power to change the contract."[6] The Court then purported to distinguish the Tennessee Supreme Court case of *Holston National Bank v. Wood*[7] on the ground that the *Wood* note called for a "reasonable attorney's fee," in "which event the matter is left to the court to determine what is a reasonable fee."[8]

The result reached by the Court of Appeals on this point may be right under the circumstances, but the opinion calls for unfavorable comment in two respects. In the first place, the note in the *Wood* case did not stipulate for a "reasonable attorney's fee." It expressly provided that a ten percent attorney's fee would be paid. In the second place, the *Wood* case very clearly took the position that "[w]hile a stipulation in a note for an attorney's fee is valid and will be enforced by this court, the court is not bound by a provision to the effect that any particular amount shall be allowed for such fees, and no matter what stipulation as to the amount is made in the face of the note, it will not be enforced unless it appears reasonable to the court."[9] In fact, the *Wood* Court awarded the holder less than the specified ten percent.

5. 255 S.W.2d 703 (Tenn. 1952).
6. *Id.* at 706.
7. 125 Tenn. 6, 140 S.W. 31 (1911).
8. 255 S.W.2d at 706.
9. 125 Tenn. at 16, 140 S.W. at 34.

The *Wood* case is in line with the almost universal view that the amount of attorney's fees fixed by the parties in bills and notes is not conclusive and that the amount recoverable is within the control of the court.[10] By the same token, the view expressed by the Court of Appeals in the principal case to the effect that the court has "no power" to change the amount of the fee where a definite amount is stipulated not only is out of line with the view of the Supreme Court in the *Wood* case, but it also is contrary to the rule adopted in virtually all jurisdictions.[11] There is good reason why the amount recoverable should be within the control of the court even where there is a stipulation of a definite fee in the instrument. It would be contrary to sound public policy to permit the holder of an instrument unjustly to enrich himself by exacting unreasonable, unconscionable and oppressive charges or usurious interest under the guise of an attorney's fee stipulated in the instrument.[12]

Failure of Consideration as Defense of Maker of Negotiable Note. In *Norbert Trading Co. v. Underwood*,[13] the Supreme Court of Tennessee was concerned with the defendant-maker's defense of failure of consideration for a negotiable note and also with the defense that the note had not been properly assigned to the plaintiff by the payee. An incidental question involved the authority of the president of the payee corporation to transfer the note. The defendant-maker had executed the note to the payee corporation, whose president and secretary had transferred it to the plaintiff for value simply by indorsing on the note the name of the payee corporation, the names of the president and secretary in their official capacity and also the names of the president and secretary in their individual capacities. When the plaintiff sued the defendant, the latter filed an unsworn plea setting up failure of consideration and that the note was not properly assigned by the payee to the plaintiff. The only pertinent proof offered by either party was by the plaintiff to the effect that it purchased the note in question. In deciding for the plaintiff, the Court held that there arose a presumption that the plaintiff was a holder in due course and that the defendant had not rebutted that presumption; the plea denying the assignment of the note did not shift to the plaintiff the burden of proving title,

10. *E.g.*, Chesterton Bank of Maryland v. Walker, 163 Fed. 510 (4th Cir. 1908); Sewell v. Wilcox, 290 S.W. 264 (Tex. Civ. App. 1926); Richardson v. Breeding, 167 Va. 30, 187 S.E. 454 (1936); *see* Citizens National Bank v. Waugh, 78 F.2d 325, 330 (4th Cir. 1935); Merchants' Bank of Grenada v. Thomas, 121 Fed. 306, 312 (5th Cir. 1903); see BRITTON, BILLS AND NOTES 145 (1943).

11. *E.g.*, *In re* Gebhard, 140 Fed. 571 (M.D. Pa. 1905); Sarasota Publishing Co. v. E. C. Palmer & Co., 102 Fla. 303, 135 So. 521 (1931); Richardson v. Breeding, 167 Va. 30, 187 S.E. 454 (1936); First National Bank v. Larsen, 60 Wis. 206, 19 N.W. 67 (1884).

12. *See* Citizens National Bank v. Waugh, 78 F.2d 325, 329, 331 (4th Cir. 1935); Holston National Bank v. Wood, 125 Tenn. 6, 16, 140 S.W. 31, 34 (1911); Richardson v. Breeding, 167 Va. 30, 187 S.E. 454, 455 (1936).

13. 253 S.W.2d 722 (Tenn. 1952).

since there was no evidence of failure of consideration and no evidence to overcome the presumption that the plaintiff was a holder in due course.

While it is possible to transfer a negotiable instrument by the use of a qualified indorsement ("'without recourse' or any words of similar import") so that the transferor's liabilities are only those of a common law assignor,[14] the transfer of a negotiable instrument by a blank, unqualified indorsement such as occurred in the case at hand is a negotiation, and the rights of the parties are governed by the law of negotiable instruments rather than by the law of assignments.[15] To put a more extreme case than the one on hand, even the use of the language of assignment accompanying the signature of the transferor generally is not enough to constitute a qualified indorsement.[16] The word "assign" is not taken to be of similar import to the qualified indorsement "without recourse," and, therefore, such transfer is a negotiation by an unqualified indorsement.[17]

Since the transfer in the present case constituted the negotiation of a negotiable instrument by an unqualified indorsement, the rights of the transferee were governed by the universally adopted Negotiable Instruments Law. That being so, the rights of the plaintiff are clear. When a plaintiff establishes that he is a holder, there arises a prima facie presumption that he is a holder in due course.[18] Section 52 of the N.I.L. defines a holder in due course as 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

14. These warranties are found in § 65 of the Negotiable Instruments Law, TENN. CODE ANN. § 7389 (Williams 1934). The words which will constitute a qualified indorsement, limiting the indorser's liabilities to that of an assignor, are found in § 38 of the Negotiable Instruments Law, TENN. CODE ANN. § 7362 (Williams 1934).

15. See BRITTON, BILLS AND NOTES § 58 (1943).

16. Therefore, the transferee from the payee may qualify as a holder in due course and recover from prior parties free from personal defenses and equities. Jones County Trust & Savings Bank v. Kurt, 192 Iowa 965, 182 N.W. 409 (1921) ("I do hereby assign," followed by signature of payee, constituted a negotiation and not an assignment. Consequently, the transferree became a holder in due course, cutting off personal defense of fraud.). To the same effect: Divelbiss v. Burns, 161 Miss. 724, 138 So. 346 (1931); Fay v. Witte, 262 N.Y. 215, 186 N.E. 678 (1933); *cf.* Duffy's Adm'r v. O'Connor, 66 Teun. 498 (1874) (under common law).

17. See BRITTON, BILLS AND NOTES § 58 (1943).

18. NEGOTIABLE INSTRUMENTS LAW § 58, TENN. CODE ANN. § 7382 (Williams 1934).

any infirmity in the instrument or defect in the title of the person negotiating it.[19]

To establish that he is a holder, a plaintiff must prove that he is the payee or indorsee of a bill or note, who is in possession of it or the bearer thereof.[20] Since the note involved in the instant case was order paper, it could be negotiated only by the indorsement of the payee and delivery to the plaintiff,[21] who then became the indorsee in possession. Plaintiff's position in the present case was not as strong as it might have been in this connection by reason of the fact that it did not offer any direct proof that the payee did indorse the note, although plaintiff's president testified without contradiction that it bought the note. Since the defendant's pleadings apparently did not properly tender the issue of the genuineness and adequacy of the indorsement of the payee, it was not necessary that the plaintiff offer proof concerning the payee's indorsement. Defendant's plea of non-assignavit (that the note was not properly assigned to plaintiff) does not appear sufficient to raise even the issue of assignment, because it was not under oath.[22] Since defendant's pleadings had not put into issue the matter of whether the plaintiff was a holder in due course, the plaintiff had made out a prima facie case entitling it to recover by presenting the note with the indorsement of payee on it and the testimony that the plaintiff had purchased the note.[23] In short, the plaintiff had proved that it was a holder, which gave rise to the accompanying presumption that it was a holder in due course, and this entitled the plaintiff to a verdict, since

19. TENN. CODE ANN. § 7376 (Williams 1934).

20. NEGOTIABLE INSTRUMENTS LAW § 191, TENN. CODE ANN. § 7515 (Williams 1934).

21. NEGOTIABLE INSTRUMENTS LAW § 30, TENN. CODE ANN. § 7354 (Williams 1934).

22. See CARUTHERS, HISTORY OF A LAWSUIT § 241 (7th ed., Gilreath, 1951).

23. Klingstein v. Thomas Circle Cafe, 68 App. D.C. 5, 92 F.2d 554 (D.C. Cir. 1937); McDuffee v. Kelsey, 312 Mass. 458, 45 N.E.2d 258 (1942); Kots v. Sachs, 185 Misc. 224, 57 N.Y.S.2d 622 (N.Y. City Ct. 1945); Beck v. Maller, 131 App. Div. 243, 115 N.Y. Supp. 596 (2d Dep't 1909); Cox v. Parsons, 165 Va. 575, 183 S.E. 440 (1936); *cf.* Farmington State Bank v. Delaney, 167 Minn. 394, 209 N.W. 311 (1926). See also BRITTON, BILLS AND NOTES § 99 (1943). Plaintiff may get some help here by § 16 of the Negotiable Instruments Law, TENN. CODE ANN. § 7340 (Williams 1934), which provides that, where an 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 shown. This provision was applied in helping to make out a prima facie case for a holder in Nevil v. Bank of Whitehouse, 158 Tenn. 251, 12 S.W.2d 709 (1929). An allegation in the pleading that plaintiff is the "owner and holder" of the note in question and proffert of the note are sufficient to show, prima facie, that plaintiff is a holder in due course. Reconstruction Finance Corp. v. Patterson, 171 Tenn. 667, 106 S.W.2d 218, 107 S.W.2d 513 (1937).

It is not clear from the opinion in the principal case whether plaintiff took the note before maturity, which is a requisite of a holder in due course. NEGOTIABLE INSTRUMENTS LAW § 52, TENN. CODE ANN. 7376 (Williams 1934). However, unless the indorsement shows the contrary, it is presumed that he took it before maturity. NEGOTIABLE INSTRUMENTS LAW § 45, TENN. CODE ANN. § 7369 (Williams 1934).

defendant had not proved a defect in the plaintiff's title. The presumption was not repelled merely by pleadings denying the plaintiff's ownership or the essentials of holding in due course.[24] If a mere allegation in the pleadings could deprive the holder of the benefit of the presumption, it would be practically worthless. It is only when a defendant proves a defect in the title to the instrument that there shifts to a plaintiff the burden of actually proving that he is a holder in due course. That is to say, it is only when a defendant has established a defective title by proof of a good defense against the party with whom defendant dealt that the presumption of due course holding by plaintiff is destroyed.[25]

The Negotiable Instruments Law defines defective title as follows: "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."[26] It is to be noted that neither want nor failure of consideration — one of the defenses asserted in the case at hand — is specifically listed as creating a defective title. While there is a split on the point, perhaps the numerical weight of authority, including Tennessee, is to the effect that proof of want or failure of consideration (material breach of contract by the party with whom defendant dealt) does not amount to proof of "defective title."[27] Consequently, under this view, even a defendant's proof of failure of consideration, to say nothing of his mere plea thereof unsupported by any evidence, does not shift the burden to plaintiff to show that he is a holder in due course. Under this prevailing view, a defendant must carry the burden of proving that plaintiff is not a holder in due course when he defends on failure of consideration. Otherwise, the presumption that plaintiff is a holder in due

24. Gulf States Steel Co. v. Ford, 173 N.C. 195, 91 S.E. 844 (1917); First National Bank v. Wallace, 50 N.D. 330, 196 N.W. 303 (1923); Rivers Bros. v. C.F.T. Co., 124 Ore. 157, 264 Pac. 368 (1928); Dull v. Mitchell, 283 Pa. 88, 128 Atl. 734 (1925). The New York case of Eichinger v. Zimmerlein, 230 App. Div. 708, 243 N.Y. Supp. 155 (2d Dep't 1930), which took a contrary position, seems wrong. For a criticism of this case, see BRANNAN, NEGOTIABLE INSTRUMENTS LAW 719 (6th ed., Beutel, 1938).

25. See BRITTON, BILLS AND NOTES § 104 (1943). Section 59 of the Negotiable Instruments Law provides: "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." TENN. CODE ANN. § 7383 (Williams 1934).

26. NEGOTIABLE INSTRUMENTS LAW § 55, TENN. CODE ANN. § 7379 (Williams 1934).

27. *E.g.*, Reconstruction Finance Corp. v. Patterson, 171 Tenn. 667, 106 S.W.2d 218, 107 S.W.2d 513 (1937); *see* Title Guarantee & Trust Co. v. Pam, 232 N.Y. 441, 134 N.E. 525, 528 (1922). See BRITTON, BILLS AND NOTES § 104 (1943) for a collection of cases on both views as well as that authority's statement of preference for the minority view.

course is not repelled, and plaintiff is entitled to a verdict.[28] Even under the minority view that proof of want or failure of consideration is proof of defective title, defendant in the instant case did not shift the burden to the plaintiff, because he offered no such proof. Moreover, section 24 of the Negotiable Instruments Law raises a presumption of consideration in actions on negotiable instruments.[29] Defendant offered no proof to rebut that presumption.

The Court gave some consideration to the question whether the president of the payee corporation had power to negotiate the note to the plaintiff. Here, too, the decision is in line with the modern tendency in its holding that the president had the power, although no by-law or resolution is shown giving him such power.[30] This rule is particularly applicable to the case at hand, because the corporation had received and retained the benefits of the transaction.

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28. *E.g.*, Reconstruction Finance Corp. v. Patterson, 171 Tenn. 667, 106 S.W.2d 218, 107 S.W.2d 513 (1937).

29. It provides: "Every negotiable instrument is deemed prima facie to have been issued for a valuable consideration; and every person whose signature appears thereon to have become a party thereto for value." TENN. CODE ANN. § 7348 (Williams 1934).

30. See 2 FLETCHER, CORPORATIONS § 601 (Perm. ed., Jones, 1931) and cases cited therein.