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Bills and Notes - Antecedent Debt - Accomodation Parties

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RECENT DECISIONS

Bills and Notes—Antecedent Debt—Accommodation Parties— Defendant Allen embezzled $15,000.00 from his employer, Security State Bank. The bank was indemnified against such losses by plaintiff. After discovery of the loss, the bank demanded promissory notes from defendant Allen to cover the shortage, such notes to be signed by "reputable and solvent citizens." A note for $8,500.00, dated 12-9-52, was executed by defendant Allen "and soon afterwards by defendants Stitgen and Dollard." Plaintiff paid the losses and was assigned the note. *Held,* on appeal by plaintiff from judgment for defendant, Stitgen, on the note, affirmed. Where a note is given as security for a pre-existing indebtedness of the maker; and, thereafter, the defendant signs as accommodation maker, without any further value given, or the liability of the primary maker affected in any manner, the accommodation maker's obligation is without consideration; and the note is unenforceable against him. *London and Lancashire Indemnity Co. v. Allen,*——Wis.——,74 N.W. 2d 793 (1956).

The decision is the logical consequence of *In re Vogel's Estate,*[1] upon which it is expressly rested. The court's synopsis of the facts in the earlier case is, however, confused to a degree which makes it extremely difficult to appreciate the tantalizingly close point of law upon which both the instant case and the *Vogel* decision turn.

In the principal case, the *Vogel* case was synopsized as follows:

> "The legal situation is as it was in *Estate of Vogel* . . ., where a loan was made to the primary maker and his note given. Some three months later his uncle was induced to sign the note. We held that the latter signature was given without consideration."[2]

Actually, Paul Vogel was the *son* of William Vogel. An arrangement was made between father and son whereby the son managed the father's farm, paid expenses and collected the income in return for supporting the father for life. Paul Vogel borrowed $800.00 from his *uncle,* Sommerfeldt, to pay expenses of the farm. *Three weeks* after receipt of the money, at the Vogel homestead, Paul, his wife, and William Vogel *simultaneously* executed a note to Sommerfeldt. An action was brought on the note against the estate of William Vogel.[3] The court found for the defendant on the ground that the original loan was not founded on any inducement coming from William Vogel; that

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[1] 259 Wis. 73, 47 N.W.2d 333 (1950).

[2] London and Lancashire Indemnity Co. v. Allen, ——Wis.——, 74 N.W.2d 793 (1956).

[3] The majority of the facts stated were obtained from the decision in In re Vogel's Estate, *supra,* note 1. However the fact of simultaneous execution by the principal maker and accommodation maker was acquired from the attorney's briefs.

the loan was a completed transaction when the money was transferred; that no further consideration was given nor was the liability of Paul Vogel affected when William Vogel signed the note.

The *Vogel* decision and the instant case have but two essential features in common: the fact that, in both cases, the origin of the debt lay in a transaction which had been consummated prior to the giving of the instrument; and the fact that, in both cases, accommodation signers were procured to join the principal debtor on the note. They have, on the other hand, two points of distinction (which may well be distinctions without difference): in the principal case, the origin of the debt lay in a tort, whereas in the *Vogel* case it lay in contract; and, in the principal case, some two days elapsed between the signature of the principal debtor on the note and that of his subsequently procured accommodation signer,[4] whereas in the *Vogel* case the signatures were simultaneous.

These two decisions affect a practical problem of everyday finance, e.g. a creditor on a matured debt is faced with a default, and is willing to extend time for payment, de facto, if he acquires additional security, but does not wish to bind himself legally to such extension. The practical method of effecting this result is to accept a demand note signed by the debtor and a surety. Under a strict rule, as adopted in both above-cited cases, a debtor is prohibited from obtaining such de facto extensions under the above circumstances. If such de facto extension is granted under a demand note, the creditor does not receive the additional security that he bargained for, and the intentions of the parties are thereby thwarted.

It may be broadly accepted as the rule of the *Vogel* case that under no circumstances can an accommodation signer be held liable on a negotiable demand note given solely in consideration of and as security for a pre-existing debt of the accommodated party, absent any participation, actual or constructive, by the accommodation signer in the transaction which gave rise to the antecedent debt.

It is significant that, so stated, the rule is entirely unaffected by the question whether the co-makers (one accommodated, the other accommodation) sign simultaneously or otherwise. The sole importance of such a question exists in the case of a note executed by the principal debtor, delivered, and accepted *simultaneously with* the originating transaction. In such a case the later-signing accommodation party is exempted from liability *unless* his signature, affixed to the instrument substantially after execution, delivery, and acceptance, is *deemed* simultaneous, i.e., is constructively simultaneous.[5] It will be so deemed,

[4] This fact was also obtained from attorney's briefs in the principal case, *supra*, note 2.

[5] "It seems clear that one who indorses a note in pursuance and consummation of

in substantially all jurisdictions, where the accommodation signer personally promised, at or prior to the execution of the instrument, that he would join in the instrument; and there is little quarrel that, even where the (or an) accommodation signature is promised only by the principal debtor, a later signing accommodation party who executes with knowledge of the promise is liable as a constructively simultaneous signer.[6] In a few cases, the knowledge element, too, is dispensed with.[7]

Obviously, however, none of the cases involving the complex concept of constructively simultaneous signatures are pre-existing debt cases in any real sense of the term. It is the writer's purpose to suggest, not so much that the sometimes-called "stranger rule"[8] is itself bad, but that the application of that rule universally to pre-existing debt cases is illogical, and not necessarily indicated by the authorities other than the Wisconsin Court.

Certain it is that nothing in the Uniform Negotiable Instruments Law compels such universal application of the stranger rule. NIL 29[9] provides:

> "An accommodation party is one who has signed the instrument as maker, drawer, acceptor, or indorser, without-receiving value therefor, and for the purpose of lending his name to some other person. Such a person is liable on the instrument to a holder for value, notwithstanding such holder at the time of taking the instrument knew him to be only an accommodation party."

NIL 25[10] provides:

> "Value is any consideration sufficient to support a simple contract. An antecedent or pre-existing debt constitutes value; and is deemed such whether the instrument is payable on demand or at a future time."

Quite evidently, these sections express no exceptions or limitations

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a prior agreement between the maker and payee of which he has knowledge, participates in the original consideration for the note, and is therefore bound . . ." Devitt v. Foster, 159 Miss. 687, 132 So. 182 (1931).

[6] Kugle, V. Traders' State Bank of Clebourne, Tex. Civ. App., 252 S.W. 208 (1923).

[7] Mitchell v. Planters' Bank, 27 Tenn 216 (1847).

[8] ". . . the general rule sustained by the great weight of authority is that the undertaking of one not a party to the original transaction who, in pursuance of some subsequent arrangement and not by reason of an agreement at the time of the original transaction of which he has notice or knowledge, signs as a surety, guarantor, indorser, or co-maker, after the original contract has been fully executed and delivered, is a new and independent contract, and to be binding must be supported by a new and independent consideration from that of the original contract. However, such new consideration need not pass to the party signing, but may be a benefit or advantage to the party debtor, or a detriment to the party creditor, on the note . . ." 7 AM. JUR., BILLS AND NOTES, §250, pp. 947-948.

[9] WIS. STATS. (1955) §116.34.

[10] WIS. STATS. (1955) §116.30.

on their stated coverage. It is this fact which has prompted Professor Britton to contend for what amounts to a complete abrogation of the stranger rule:

> "Section 25 of the N.I.L. deprives, or should deprive every promisor on a negotiable instrument, no matter how or when he signed, of the defense of no consideration, so long as he signed for the purpose of paying or securing his own antecedent debt or that of another."[11]

This writer, fully recognizing the force of Britton's argument that ". . . by recognizing an antecedent debt as consideration in any case, there is no logical stopping place until the end of the series is reached,"[12] nevertheless suggests a confinement of the stranger rule to cases where the accommodation signer is a party neither to the transaction giving rise to the debt, nor to the transaction of original execution, delivery, and acceptance of the negotiable instrument subsequently given to secure the same. Such a suggestion appears to have two predominant virtues: first, it does not run directly counter to the great mass of existing authority establishing the stranger rule; and second, it lends appropriate recognition to the independence of a negotiable instrument as a derivative of the common law specialty.

Authority for this suggestion has been established by two early cases. In *Grocer's Bank v. Penfield*,[13] the makers signed a note for the accommodation of the payee who indorsed the note to his creditor as security for his antecedent debt. The makers were held liable, the court stating:

> ". . . it is universally conceded that the holder of an accommodation note, without restriction as to mode of using it, may transfer it either in payment or as collateral security for an antecedent debt, and the maker will have no defense. The existing debt is a sufficient consideration for the transfer and no new consideration need be shown. . . . it must be regarded as settled that an indorsee of a negotiable note made for the accommodation of the indorser, but without restriction as to its use, taking the note in good faith as collateral security for an antecedent debt, and without other consideration, is entitled to the position of a holder for value, and not affected by the defense of want of consideration to the maker."

It can be seen from these facts that, although the accommodation makers were not parties to the transaction giving rise to the debt, they were parties to the execution, delivery, and acceptance of the security note; since their names appeared on it as makers. The makers, however, fall within the stranger rule, as applied by the Wisconsin Court,

[11] Britton, BILLS AND NOTES, pp. 384-385.
[12] *Supra*, note 11, p. 384.
[13] 69 N.Y. 502, 25 Am. Rep. 231 (1877).

by virtue of their not having participated in the original debt-creating transaction. Thus the New York Court impliedly followed the limitation suggested by the writer. This case has been strictly followed in a number of subsequent decisions.[14]

Authority for the proposition has also been established independently by the case of *Jordan v. Goodside*.[15] In that case, C had borrowed funds through the plaintiff. Ten months later, C indorsed a note, given him for accommodation by the defendant, to the plaintiff. Again the maker was held liable, the court stating:

> "In *Smith v. Bibber,* 82 Me. 34, 19 Atl. 89, 17 Am. St. Rep. 464, the court declared that were the question a new one in this state, they would be inclined to adopt the contrary rule which was that of the federal court and of most other jurisdictions, but they adhered to the doctrine established here. However, this doctrine has been abrogated by the N.I.L. §25. This changed rule was applied in *Merrill Trust Co. v. Brown,* 122 Me. 101, 119 Atl. 109, a case decided after the passage of the Negotiable Instruments Act, and is now the law in this state. It follows that the plaintiff was a holder for value, even if he took the note as security for a pre-existing debt."

It can be clearly seen under these facts that the maker again was a party to the security-note transaction, but was a stranger to the debt transaction. It is possible to argue that the maker was not, in the fullest sense, a stranger; since C had promised the plaintiff, at the time of the debt transaction, that he would get the plaintiff "something to protect him." The writer feels, however, that this nebulous phraseology is insufficient to remove the maker from the stranger category. It appears rather definitely that the Maine Court also intended to restrict the application of the stranger rule as suggested above.

The independent significance of a negotiable instrument seems to have been established by the historical development of the law of bills and notes. Under Law Merchant, the first repository of the law of this subject, it appeared that no consideration was necessary for such instruments.[16] Aigler, in discussing the problem, states his conception of consideration under the Law Merchant as follows:

> "If consideration was necessary to secure a binding promissory obligation in the form of a bill or note, it is far more likely that it was that broader 'consideration' or 'clause' which was a feature of the Civil Law rather than the consideration that developed at common law."[17]

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[14] Maurice v. Fowler, 78 Misc. 357, 138 N.Y.S. 425 (1912); Martin L. Hall Co. v. Todd, 139 N.Y.S. 111 (1912); In re Hopper-Morgan Co., 154 Fed. 249 (1907).
[15] 123 Me. 330, 122 Atl. 859 (1923).
[16] Ralph W. Aigler, CASES ON THE LAW OF BILLS AND NOTES, 2nd Edition, (1955) p. 411.
[17] *Supra,* note 16.

The common law courts apparently recognized and maintained the validity of this position, after absorbing the Law Merchant in the common law, placing a negotiable note in the category of a specialty which demanded no consideration.[18] A bill or note, as a specialty, was considered independently of any consideration pertaining to the transaction from which it resulted. The constant common law emphasis upon the necessity of consideration in any contractual-type transaction, however, led to an inevitable confusion in the case of bills and notes. As concerns the type of transaction now under consideration, the confusion should have been abrogated by the adoption of N.I.L. §25,[19] stating that an antecedent debt constitutes value.

The writer's opinion that the historically established independence of a negotiable instrument should be maintained is further substantiated by N.I.L. §24,[20] i.e., where a bill or note is given as security for a contract which has been breached, and an action on the security instrument results, the facts pertaining to the secured contract need not be affirmatively proven, since only the facts pertaining to the security instrument itself are of importance, prima facie.

The Wisconsin Court has recognized that a maker may be liable on a promissory note given for an antecedent debt.[21] The two Wisconsin cases[22] under consideration also infer that an accommodation party who has participated in the original debt transaction may be held liable on a subsequent security note. A later Wisconsin case[23] has stated that a negotiable instrument given in exchange for a pre-existing moral obligation is a new and independent contract. Based upon a consideration of authority and the historical development of the law of negotiable instruments, it seems logical that the court should also hold an accommodation signer liable who has participated, not in the debt transaction, but in the security-note transaction, on the theory that such a signer is not a stranger within the application of the stranger rule. As a corollary, the stranger rule should be applied only to those cases in which the accommodation party on the security note has participated in neither the debt nor the security transaction,[24] or where the accommodated person is not a party to the security instrument.[25]

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[18] *Supra*, note 16.
[19] *Supra*, note 10.
[20] "Every negotiable instrument is deemed prima facie to have been issued for a valuable consideration; and every person whose signature appears thereon to have been a party thereto for value." WIS. STATS. (1955) §116.29.
[21] Elbinger v. Capitol & Teutonia Co., 208 Wis. 163, 242 N.W. 568 (1932).
[22] *Supra*, note 1; *supra*, note 2.
[23] Garvey v. Wenzel, ——Wis.——, 76 N.W.2d 291 (1956).
[24] *Supra*, note 8.
[25] Turle v. Sargent, 63 Minn. 211, 65 N.W. 349, 56 Am. St. Rep. 475 (1895).