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Burden of Proof of Due Course Holding Under Negotiable Instruments Law

Walter E. Treanor
Indiana University School of Law

BURDEN OF PROOF OF DUE COURSE HOLDING UNDER NEGOTIABLE INSTRUMENTS LAW

The unvarying rule at common law recognized that the holder of a negotiable instrument was presumed to be a holder in due course and the decisions all agree that the defendant is met at the outset by some sort of a *prima facie* case of due course holding. The courts also agree that, when the defendant had shown that the instrument originated in fraud, the burden of proof in respect to the plaintiff's due course holding shifted to the plaintiff. Yet the courts did not agree as to what actually happened when the burden of proof shifted.[1] Apparently they took different views of the nature of the "burden of proof" which shifted to the holder. To some it meant merely a duty of going forward with the evidence, the defendant still having the burden of "establishing the issue," while to other courts it meant that the plaintiff-holder must carry the burden of affirmatively establishing his character of due course holder. As respects notice or bad faith, there is a minority view that held that the burden remained on the defendant, although the burden of proving the other elements of due course holding shifted to the plaintiff.[2]

The Negotiable Instruments Law expressly declares "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."[3] Section 52 N. I. L. sets out in detail the facts which must exist in order for one to be a holder in due course.[4] If these two sections are construed together and each given an unstrained meaning it would seem that the conflicts should disappear. However the courts have assimilated the expression "the burden is on the holder to prove" to the old phrase "burden

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[1] Cases prior to Negotiable Instruments Law: *National Bank of North America v. Kirby*, (1871) 108 Mass. 497, 500; *Cover v. Myers*, (1892) 75 Md. 406, 23 Atl. 852; *Cummings v. Thompson*, (1872) 18 Minn. 246; *Collins v. Martin*, (1879) 1 Bos. & P. 648, 651, 126 Eng. Rep. R. 1113; *Ross v. Drinkard*, (1860) 35 Ala. 434; *Citizens Trust & Savings Bank v. Stackhouse*, (1912) 91 S. C. 455, 74 S. E. 977, 40 L. R. A. (N. S.) 454; *Vathier v. Zane* (1849) 6 Gratt. (Va.) 246.

[2] *First National Bank of Council Bluffs v. Moore*, (1906) 148 Fed. 953, 958; *Young v. Lowry*, (1912) 192 Fed. 825; *Washington, etc., Ry. Co. v. Murray*, (1914) 211 Fed. Rep. 440; *Crosby v. Reynolds*, (1912) 196 Fed. Rep. 640.

[3] Sec. N. I. L.: Burns, *Ann St. Rev.* 1914 §9089G2. 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. But the last-mentioned rule does not apply in favor of a party who became bound on the instrument prior to the acquisition of the defective title.

of proof" and since "burden of proof" had two well recognized meanings it becomes necessary to "interpret" the expression in section 59 instead of giving it its obvious meaning. In *Downs v. Horton,* (Supreme Court of Missouri 1921, 287 Mo. 414, 230 S. W. 103), the court says: "The judges and text-writers had constantly used the term 'burden of proof' and 'shifting of the burden of proof' back to the defendant in discussing this subject and there is no reason to say as was intimated in *Link v. Jackson,* 158 Mo. App. 63, 86, 139 S. W. 588, that any other or different meaning was intended when codifying the general law into the Negotiable Instrument Act." The court also says that the provision in the N. I. L. "is a codification of and in accordance with the law of this state as previously established," and concludes that the "burden is only placed on the plaintiff to overcome the *prima facie* defense arising from fraud in procuring the note," and "is different from plaintiff's failure to prove the facts of his petition necessary to constitute a cause of action." But in *Leavitt v. Thurston,* 38 Utah 351, 113 Pac. 77, the court took the view that the section in question casts upon the holder, upon proof of fraud, not merely the duty of going forward, but the burden of establishing that he or some one under whom he claims, acquired the title as a holder in due course; that the burden of proof remains on the holder and does not shift, though the burden of proceeding may shift, even though the defendant introduces no evidence to contradict the plaintiff.[5]

In Indiana the decisions of the Supreme and Appellate courts, both before and since the adoption of the Negotiable Instruments Law, have with striking consistency held that when the defendant has pleaded fraud and introduced evidence in support of the plea the "burden is on the indorsee to show himself an innocent holder,"[6] and that "he must prove, not one, but all of the essential elements of the character of a *bona fide* holder,"[7] and that the "burden of

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[4] Sec. 52. N. I. L.: Burns, *Ann St. Rev.* 1914 §9089Z1. A holder in due course is 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 any infirmity in the instrument or defect in the title of the person negotiating it.

[5] Cases under Negotiable Instrument Law: *Downs v. Horton* (1921) 287 Mo. 414, 230 S. W. 103; *Kenner v. Almon,* (1918) 80 So. (Ala.) 449; *Citizens State Bank, etc., v. Snelling,* (1919) 178 Pac. (Mont.) 744; *Metropolitan Discount v. Baker,* (1918) 97 S. E. (N. C.) 445; *Atkins x. Brown,* 208 S. W. (Mo. App.) 502; *Gebley v. Carillo,* (1918) 177 Pac. (N. M.) 804; *Schmidt v. Benedict,* (1919) 178 Pac. (Kan.) 444; *Security State Bank Wichita v. Seaunier,* (1919) 178 Pac. (Kan.) 239; *Navajo-Apache Bank & Trust Co. v. Wakefield,* (1919) 180 Pac. (Ariz.) 529.

[6] *Tischer v. Merea,* (1897) 118 Ind. 586, 21 N. E. 316.

[7] *Gilbertson v. Jolly,* (1889) 120 Ind. 301, 303, 22 N. E. 306.

proof" which he has is the burden of establishing by a preponderance of the evidence that he is a *bona fide* holder for value, or in the words of the N. I. L., a holder in due course. In *Shirk v. Neible,* the court refers to the rule as well settled "that if the holder of paper negotiable by the law merchant and to which the maker has exhibited a valid defense for fraud, relies upon the fact that he is a *bona fide* holder thereof, for value, the burden is upon him to aver and prove that he obtained such paper before maturity without notice of the defenses of the maker and that he paid a valuable consideration therefor."[8] In *Ray v. Baker et al,* the defendants answered fraud and the plaintiff's reply was a general denial. The Supreme court said that "no question as to plaintiff's being a good-faith purchaser can be raised under the issues. If appellant were a good-faith purchaser before maturity of commercial paper, the burden was upon him affirmatively to plead and to prove the same on the trial."[9] In a case under the Negotiable Instruments Law, *National City Bank v. Kirk,* the plaintiff's president had given testimony tending to show the plaintiff was a holder in due course, and such testimony was not directly contradicted. The reviewing court referred to the burden placed on the plaintiff by section 9089G2 Burns, REV. ST. 1914 and said it was a question for the jury whether the appellant had discharged this burden. "In so holding we are following the general rule, often repeated and applied in similar cases, to the effect that where a party has the burden of proving a fact in a trial before a jury, and undertakes to do so by the testimony of witnesses, the court cannot say as a matter of law that such fact has been established."[10] It is obvious that the Indiana courts are not talking of "the duty of going forward with the evidence," but of the burden of establishing the issue of due course holding by a preponderance of the evidence.

A recent Indiana decision reaffirms the rule of the previous decisions. In a suit on four notes the defendant, for answer filed four paragraphs on the theory of failure of consideration, and in addition a paragraph framed on the theory of fraud. The lower court excluded questions by the defendant, which were asked for the purpose of showing the circumstances surrounding the execution of the instrument. The questions were excluded on the theory that the defendant must first show that the plaintiff took with notice of the fraud and, consequently, was not a holder in due course. On appeal this was held to be error. *Kendall v. Turner* 149 N. E. 458 (Appellate Court of Indiana Nov. 18, 1925). The court is in harmony with previous decisions when it says: "But with the answer of fraud in the record a different rule prevails. Under such an issue when appellee introduces evidence tending to impeach the consideration for the note sued on, and to

[8] *Shirk v. Neible,* (1901) 156 Ind. 66, 59 N. E. 281.

[9] *Ray v. Baker et al,* (1905) 165 Ind. 74, 74 N. E. 619.

[10] *National City Bank v. Kirk* (Appellate Court, Indiana 1922) 134 N. E. 772.

show that the note was procured by fraud, appellant must then assume the burden of showing that he had no notice or knowledge of the fraudulent transaction which induced the execution of the note without consideration, at the time of his purchase thereof, and that he is a *bona fide* holder in due course for value."[11]

It is submitted that the Indiana decisions are in harmony with the Negotiable Instruments law. Section 59 N. I. L.[12] does not purport to relieve the holder of his duty as a plaintiff to allege and prove the necessary elements of his cause of action, but does present him with a *prima facie* case, a "real presumption" in the sense that Dean Wigmore uses the expression.[13] Instead of relieving the plaintiff from the "burden of proof" in respect to his being a holder in due course, the section merely provides that if the plaintiff shows that he is a holder, the law will raise a *prima facie* case of due course holding. He is apparently relieved of the duty of going forward with the evidence. If no defect of title exists it is not material whether plaintiff is a holder in due course or not, but when the defendant shows that there is a defect in the title, due course holding immediately becomes a necessary element in the plaintiff's cause of action, and the burden is upon him "affirmatively to plead, and to prove the same on the trial." This does not violate the rule that one who raises an issue by an affirmative defense must establish the issue by a preponderance of the evidence. The issue of fraud raised by the defendant must of course be established by him by a preponderance of the evidence. By alleging and proving fraud defendant does not raise the issue of due course holding, but his proving fraud is given the effect of destroying the plaintiff's *prima facie* case as far as due course holding is concerned.

The rule long followed by the Indiana courts that the plaintiff must prove all the essential elements of the character of a holder in due course is clearly implied in section 59 N. I. L. Even *Downs v. Horton, supra,* concedes this.

As an incidental point in *Kendal v. Turner* the court points out that the presumption that the holder is a holder in due course is not repelled by proof that the instrument, as between the immediate parties, was without consideration. This follows from the fact that want or failure of consideration is not included in the definition of "defective title."[14]

WALTER E. TREANOR.

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[11] *Kendall v. Turner* 149 N. E. p. 459.

[12] Section 59 N. I. L. *Burns, etc., supra.* Note 3.

[13] Wigmore on *Evidence,* 2d Ed. § 2491.

[14] Sec. 55. N. I. L. Burns, *Ann St. Rev.* 1914 § 9089 C 2. The title of a person who negotiates an instrument is defective within the meaning of this act 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 a fraud. See *Wheat v. Goss* (Ind. App. 1922) 139 N. E. 326.