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THE CONCEPT OF GOOD FAITH IN NEGOTIABLE INSTRUMENTS LAW

EDWARD T. FAGAN†

The requirement of purchase in good faith, as a condition of due course holding, involves consideration of one of the broadest concepts of commercial paper. Although it has been the subject of exhaustive legal analysis for more than two centuries, no consistent pattern of rules has yet been formulated which will even set the boundaries where certainty leaves off and uncertainty begins in respect to its proper application to the negotiable instrument. As a consequence, the concept exists today in an area of commercial law where the greys are still dominant and even among them the shades are innumerable.

It was frequently postulated by early writers on bills and notes that good faith was synonymous with lack of notice, although bad faith implied something more than notice.¹ The probable explanation for this *non sequitur* lies in the conflict between Canon Law and Roman Law on the meaning of good faith. Canon Law teaches that good faith is an honest belief in the validity of one's activity, whether based on true or erroneous knowledge.² Although it presupposes that the motives of valid belief are objective,³ thereby recognizing to some extent the value of ex-

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1. "Bona fides or good faith is a generic term for what is more strictly and technically called notice. If paper be purchased without anything which the law can construe into notice, it is spoken of in business parlance as being purchased in good faith. The purchaser is a bona fide purchaser. . . . [B]ad faith at bottom resolves itself into a question of honesty or dishonesty, for guilty knowledge and willful ignorance alike involve the result of bad faith." NORTON, LAW OF BILLS AND NOTES § 151 (1893).

2. "La bonne foi est une disposition de l'ame, an vertu de laquelle l'auteur d'un acte croit sincerement, que cet acte est conforme a la loi morale ou aux prescriptions legales. On peut distinguer dans cette disposition un jugement de l'intelligence et une bonne inclination de la volonte. Naturellement la bonne foi existe dans d'innombrables cas ou reellement, la dite conformite se verifie. Neanmoins dans l'usage courant on n'emploie generalement cette expression que pour designer l'antinomie qui peut exister parfois entre la droiture des dispositions interieures et la violation objective de la loi, soit naturelle, soit positive." (Good faith is a disposition of soul, in virtue of which the author of an act believes sincerely that this act conforms to the moral law or to legal requirements. One may distinguish in this disposition a judgment of the intelligence and a good inclination of the will. Naturally, the good faith exists in innumerable cases where such conformity actually exists, nevertheless, in current usage, the expression is generally employed to indicate the opposition which may sometimes exist between the rightness of internal dispositions and the objective violation of the law, natural or positive.) 2 Dictionnaire de Droit Canonique col. 957 (1935).

3. ". . . for faith two things are required: one of them is that things worthy of belief shall be proposed to man: the other requirement is that the believer shall assent to the things proposed; . . ." ST. THOMAS, SUMMA THEOLOGICA, IIa-IIae, Q. vi, Art. I, c.

ternal norms as an aid in finding good faith, it requires that it be determined by a subjective standard.⁴ Roman Law, on the other hand, rather than attempting the sometimes difficult distinction between motive and belief, made an objective standard the sole criterion in its concept of *bona fides*.⁵

Early equity chancellors were well aware of this basic conflict because of the important role both these bodies of law played in their education and legal training. Originally, they might well have sought a reconciliation, but any such search was predestined to failure. The objectivity of notice, which by then was well established in equity, made meaningless any protection which might otherwise be afforded innocent belief in face of knowledge of facts which established the legal conclusion of invalidity.⁶ It is understandable, therefore, that when equity extended protection to good faith purchasers of property, the chancellors followed the Roman Law approach and gave purely subjective belief little or no place in the determination of such purchaser status. If a reasonable man would not have purchased with actual or constructive knowledge of certain facts, good faith was held not to exist in the face of such knowledge.

As official "keepers of the king's conscience," the chancellors must have been aware, however, that some recognition was due the belief element of the Canon Law good faith concept, for conscience, or a sense of the moral goodness or blameworthiness of one's own conduct, was always a material consideration in equity rulings. Since knowledge of

4. "Notio bonae Fidei, valde diversa ab eius notione in iure romano, est mentis persuasio seu conscientia quod nihil velis aut agas quod tibi nefas esse arbitreris." (The notion of *bona fides* [in canon law] is very different from the concept in Roman Law; it is persuasion or consciousness that you will and do nothing that you believe to be forbidden you.) VAN HOVE, *DE PRIVILEGIIS* 98 n. 17 (1939).

5. *Bona fides* in Roman law has been defined as ". . . fairness, uprightness, 'playing the game,' doing in given circumstances what a self-respecting man would do. No doubt the notion was progressive. Different degrees of civilization will set different standards of decent gentlemanly conduct. But it is hardly possible that at any time after the introduction of these *bonae fidei iudicia* it can ever have been thought that a good citizen had done all that could be required of him in an ordinary commercial relation if he had steered clear of actual fraud." Buckland, *Culpa and Bona Fides in the Actio Ex Empto*, 48 L.Q. REV. 217, 228 (1932).

6. ". . . as this phrase [in good faith] has an equitable origin, resort must be had to works on equity jurisprudence to ascertain under what circumstances, the phrase is applicable; and an examination of these authorities will show beyond question, that notice and good faith cannot co-exist. For it is an equitable doctrine of universal recognition, that he who takes with notice of the claim of another, takes subject to that claim. Notice in this connection, does not mean direct and positive information, but anything calculated to put a man of ordinary prudence on the alert, is notice. So that it will be readily perceived, that the statute under consideration by the adoption of the terms 'notice' and 'good faith,' adopted them with the full force and meaning which attached to them as inseparable incidents in that system of jurisprudence from whence they were derived." *Lee v. Bowman*, 55 Mo. 400, 403 (1874).

facts which establish the legal conclusion of invalidity will not necessarily establish a belief that invalidity exists, the chancellors must have concluded that something to supplement notice was needed before bad faith could be found. Here again, however, after acknowledging the subjective element, the chancellors reverted to the objective standard. They ruled that if a reasonable man would believe from the known facts that invalidity existed, bad faith was established, regardless of subjective belief.⁷ A meaningless distinction was thus drawn between bad faith and notice. For all practical purposes they were as synonymous as good faith was with lack of notice.

The introduction of the Law Merchant into the common law had no apparent effect upon this objective approach. Judicial determinations of good faith in commercial matters were not concerned with the actual state of mind of the parties involved. A necessary prerequisite to the application of Law Merchant principles was that the undertakings were in the regular course of trade or ordinary course of business. This was, therefore, the primary consideration in such cases.⁸

However, the advent of England as the great commercial nation of the world made revision of credit paper notice concepts a commercial necessity. The tempo of the nation's mushrooming mercantile system was accelerated by an awakening competition. Its multitudinous transactions made commonplace the dealing of stranger with stranger. It became apparent that the rapid growth and quickened pace of trade had rendered obsolete any investigatory duty relating to the credit paper used to expedite such trade. The courts soon recognized that an insistence upon such duty, normally necessary to establish bona fide purchase, "would at once paralyze the circulation of all the paper in the country,

7. "The conception of 'Conscience' as an element in determining jural relations was wholly due to the clerical courts. In its practical operation and results, however, conscience, considered as a source of the equity jurisdiction, was synonymous with the 'good faith,' 'bona fides,' which forms so important a feature in the later and philosophical Roman jurisprudence. It embraced all those obligations which rested upon a person, who, from the circumstances in which he was placed towards another and the relations subsisting between them, was bound to exercise good faith in his conduct and dealings with that other person. Under the head of conscience as thus understood, a wide field of jurisdiction was opened, which included all departures from honesty and uprightness." 1 POMEROY, EQUITY JURISPRUDENCE § 56 (5th ed. 1941).

8. "The early courts do not appear to have questioned what they meant by 'good faith.' Nor to have stated just how nearly closed a purchaser might keep his eyes and still be deemed not to have 'notice' of 'infirmities' or of 'defects' in title, to use the language of N.I.L. § 52(4). Or, of 'facts making the transfer wrongful,' to quote from the Transfer Act. Probably they meant some such thing as the good faith of the regular course of business." STEFFEN, CASES ON COMMERCIAL AND INVESTMENT PAPER 585 (2d ed. 1954).

and with it all its commerce.”⁹ It was therefore held that actual knowledge of title defect or defense was the sole notice standard required of purchasers of negotiable paper. Thus, there was established in the common law the notice standard of full and free negotiability, so necessary to meet the new economic demand.

This revision of the notice standard had an immediate far-reaching effect upon the law of negotiable instruments. Although its direct result was to make constructive knowledge no longer a part of notice, it soon became apparent that a restriction of notice to actual knowledge demanded the recognition of a subjective standard for the doctrine of good faith. Obviously, if knowledge of facts which would alert a reasonable man and impose upon him a duty of further investigation was no longer sufficient to prove notice, this same knowledge was also no longer significant in itself in respect to good faith. To hold otherwise would completely defeat the purpose of the revised notice standard. Good faith therefore soon came to be defined in the law of negotiable instruments as “honesty in fact whether negligent or otherwise.”¹⁰

It follows that if a subjective standard is necessitated for good faith by virtue of the revised notice standard, the same subjective standard is required for a finding of bad faith. Otherwise, the purpose of the revision would again be completely defeated. Furthermore, since good and bad faith are attitudes of mind resulting from belief,¹¹ they exist as the product of an individual mental process. Thus, logic dictates that this existence be determined by a subjective rather than an objective standard. Unfortunately, however, logical deductions at times can be demonstrated as unworkable in fact by establishing the impossibility of their practical application. A problem arises, therefore, as to whether this requirement of a subjective standard falls within such qualification, for if it can be established that it will at times result in the imposition of unwarranted

9. *Lawson v. Weston*, 4 Esp. 56, 57, 170 Eng. Rep. 640, 641 (1801). That this same reasoning is applicable today is apparent from the opinion of an American court almost a century and a half later. “The purpose of the Negotiable Instruments Law is to enhance the marketability of such securities and to allow bankers, brokers and people generally to trade in them with confidence. That object would be defeated if liability were to be imposed upon one who, mistakenly but in good faith, deals with negotiable instruments on the assumption that they belong to the person who employs him to effect their sale through ordinary market channels.” *First Nat’l Bank of Blairstown v. Goldberg*, 340 Pa. 337, 343, 17 A.2d 377, 380 (1941).

10. “A thing is deemed to be done in good faith within the meaning of this Act when it is in fact done honestly, whether it is done negligently or not.” *English Bills of Exchange Act, 1882*, 46 Vict., c. 61, § 90.

11. Faith itself is a state of mind not necessarily dependent upon knowable fact. It is a product of belief. See *Patzwold v. United States*, 7 Okla. 232, 236, 54 Pac. 458, 459 (1898); *Rodan v. St. Louis Transit Co.*, 207 Mo. 392, 409, 105 S.W. 1061, 1066 (1907).

penalties, it should be rejected as unjust regardless of its soundness in theory.

This problem may be illustrated by situations involving bad faith based upon over-scrupulosity, ignorance, or mistaken belief. Some people are so highly suspicious and over cautious that they are circumspect to the extreme in all of their activity. Others are so ignorant that they will suspect all but the obviously good, believing firmly that evil lies in that which they are incapable of understanding. This abnormal sensitivity to real or imaginary evil, which is born of over-scrupulosity or ignorance, may be properly classified as a mental deficiency and yet is distinguishable from legal insanity. It certainly should not impose upon the afflicted individual the additional burden of complying with higher standards in business and social relationships than are required of the normal person.

Consider the person who believes that only "red-blooded Americans" are honest and that all foreigners without exception are thieves and sellers of stolen goods. It would seem, under a subjective standard, that the person is a purchaser in bad faith if he buys a negotiable instrument from an Englishman.

Consider also the immigrant who sells property and takes a certified check in payment. Through ignorance he may believe all checks worthless and legally unenforceable. If his sole reason for acceptance is to obtain evidence of the sale for later enforcement, it would seem, under a subjective test that he, too, is a bad faith holder. In both cases the penalty imposed would seem unjust because a reasonable person would not have arrived at the same conclusion from the known facts.

Partially inspired by both over-scrupulosity and ignorance, there are many whose beliefs in invalidity are based upon sincere though erroneous religious convictions. The fanatic who acquires an interest-bearing instrument, although convinced it is legally defective solely because he believes profit on a loan of money unjustifiable, is guilty of a bad faith taking, under a subjective standard. No one would seriously argue that this erroneous belief, inspired by no more than a warped concept of Christian principles,¹² should in itself prevent the enforcement of the instrument by him who is subjectively guilty but objectively blameless.

12. "Usury is strictly speaking profit exacted on a loan of money just because it is a loan. This is unjust, because money as money has no value save in its use. But interest may be justly charged for reasons extrinsic to the loan itself, such as danger of non-payment or loss of opportunities of other profit. In modern times this latter extrinsic title always exists owing to economic conditions. The amount of interest that may reasonably be charged is determined by the common estimation of intelligent men. . . ." A CATHOLIC DICTIONARY 509 (2d ed. 1952).

A more complicated situation exists when the belief in legal invalidity is based upon mistaken fact or upon facts which in law establish a defense, rebuttable, however, by other facts ascertainable upon further investigation. The belief based upon facts which establish a rebuttable defense in law may be illustrated by the case of the corporate official who endorses and transfers a corporate payee note to a third party in payment of his own personal obligation. Prima facie, the official is committing a breach of trust by such transfer because in fiduciary law an agent is presumed to be acting wrongfully when he deals adversely to the interests of his principal.¹³ However, if this corporate official, as the president of a close corporation, is expressly authorized to use corporate assets outside the scope of the corporate business and it can be shown that the transfer will not render the corporation insolvent, then these further facts rebut such presumption of invalidity. Nevertheless, a purchaser who believes, on the strength of the presumptive facts, that there is a defect in the title to the instrument, is guilty of a bad faith holding under a subjective standard.

The case of the negotiable instrument which is erroneously dated so as to appear overdue at the time of acquisition is the basis for an example of how belief in invalidity may be founded upon mistake in fact. Actually, the instrument may not have passed maturity at the time of transfer but the incorrect date would seem to indicate that fact. The purchaser who believes the instrument invalid because he thinks it is overdue is a bad faith purchaser subjectively, even though investigation would disclose that the facts upon which such belief is based are false.

The complicating factor in these last two illustrations is that a reasonable man might very well arrive at the same belief based upon the known or apparent facts. If so, even under an objective standard the purchaser of such instrument should be deemed a bad faith holder. It has been suggested that any other conclusion is illogical because although that which motivates the belief is erroneous or unfounded, the belief is nevertheless correct as a conclusion if the instrument is legally unenforceable for some other reason.¹⁴

Despite this contention, courts have said in such cases that a duty to investigate exists because the real or apparent facts establish a rebuttable defense in law, and it is presumed that the person under such

13. Fagan, *Notice and the Endorsing Fiduciary*, 30 ST. JOHN'S L. REV. 153, 184 (1956).

14. Note, 36 HARV. L. REV. 321, 324 (1922).

duty has made such investigation.¹⁵ If investigation would have uncovered other facts which would rebut the presumption of legal invalidity or which would establish that the apparent fact which inspired the duty was not a real fact,¹⁶ then the person is presumed to know these additional clarifying facts. Belief in invalidity in face of such knowledge is an unreasonable belief. Actually, the courts are utilizing constructive knowledge in these instances to protect the purchaser rather than to defeat him. It would seem, therefore, that the common law is just as reluctant to penalize a holder for a reasonable belief in legal invalidity based upon error as it is to penalize a holder for an unreasonable belief. It is submitted that this reluctance is justified in both instances because, although invalidity may actually exist, a belief in invalidity which is motivated by other than facts which establish such invalidity directly or indirectly, is an unfounded belief regardless of whether it may appear reasonable. Because such belief is unfounded, it should be treated in the same manner as all other unfounded beliefs and no legal penalty should result to the believer. Such would not seem to be the case, however, under a subjective standard.

The solution to this problem lies in part in the simple distinction which is drawn in law between legal conclusion and facts or circumstances which permit the deduction of legal conclusion. That a defense or a defect in title exists is a legal conclusion. A person may not be actually aware of legal conclusion although he has actual knowledge of facts which permit the deduction of legal conclusion. His ignorance of legal effect is immaterial in such cases and he is said to have an awareness of the legal conclusion which stems from the known facts.¹⁷

On the other hand, a person may not have knowledge of the facts or circumstances which in themselves permit the deduction of legal conclusion but he may still have an awareness of legal conclusion. This belief

15. *Wilson v. Metropolitan Elevated Ry. Co.*, 120 N.Y. 145, 24 N.E. 384 (1890); *Buckley v. Lincoln Trust Co.*, 72 Misc. 218, 131 N.Y. Supp. 105 (1911). See *Ward v. City Trust Co.*, 192 N.Y. 61, 70, 84 N.E. 585, 588 (1908); *Morehead v. Harris*, 121 Ark. 634, 182 S.W. 521, 523 (1916); *Charles A. Hill and Co. v. Belmont Heights Baptist Church*, 17 Tenn. App. 603, 608, 69 S.W.2d 612, 615 (1933).

16. In *Cowing v. Altman*, 71 N.Y. 435 (1877), a check was delivered by the drawer to the payee long after its date and on the same day was transferred by the latter for value. The court held the purchaser a holder in due course and not subject to any defense since investigation would have disclosed that the check was actually not overdue although, *prima facie*, such was the fact.

17. "If he knows the facts and still honestly believes that he has title, it will avail him nothing, for in that case the *bona-fides* of his claim of ownership must be based on the legal effect of the facts as known to him and not on his opinion of the law to be applied to the known facts." *Raney v. Home Ins. Co.*, 213 Mo. App. 1, 7, 246 S.W. 57, 60 (1922). See *Cook v. American Tubing and Webbing Co.*, 28 R.I. 41, 65 Atl. 641 (1906). See also *Smith v. Lawson*, 18 W. Va. 212 (1881).

or awareness of legal conclusion, which is a state of mind and therefore subjective, is the equivalent of actual knowledge of the facts upon which such conclusion is based if it is the product of communicated information or external circumstantial evidence.¹⁸

Authorities have uniformly recognized that notice exists when information is received from a proper source which establishes an awareness of legal conclusion in the mind of the receiver although the information does not include facts from which such legal conclusion may be directly deduced. As stated by Professor Bogert:

“. . . if a prospective purchaser is told by word of mouth or by writing by the equity claimant that the latter has an equitable interest in the property which cannot be shut out by a sale by the legal title holder, and this statement is true, and thereafter the purchaser takes legal title, he obviously has ‘actual notice’ of the equity and in conscience ought to hold subject to it. Here the purchaser does not ‘know’ that the equity exists in the claimant, but he knows that the claimant asserts an equity. Knowledge of the assertion of an equity, which later proves to be an existing property right, is sufficient to constitute ‘notice’ under the rules of equity.”¹⁹

A negative approach has sometimes been employed to reach the same conclusion. Under this approach, it is sufficient for notice that belief exists of fraud or illegality in the transaction as a whole. Notice of the specific facts which impeach the validity of the instrument or transaction need not be present to establish such notice. This reasoning finds its expression in the general principle that “wilful rejection of knowledge is the equivalent of knowledge or bad faith.”²⁰

18. As stated in *Link v. Jackson*, 147 S.W. 1114, 1115 (1912), “If a fact exists, and a party has such knowledge of it as to cause him to believe that it exists, and he acts upon that belief, the result is the same as if he had actual knowledge of the fact and acted upon that. If the note in suit was procured by fraud, and the plaintiff had such knowledge bearing upon that question as to cause him to believe that it was procured by fraud, then, as far as his action in purchasing the note is concerned, he knew that the note was procured by fraud. Belief is the conviction that arises in the mind as a result of knowledge of facts calculated to produce that conviction. If, as a matter of fact, the note was procured by fraud, then knowledge of facts bearing on that question which go no farther than to arouse suspicion are not sufficient; but, when the impression made upon the mind by knowledge of facts relating to such fraud passes from the realm of suspicion and grows to belief, it then becomes knowledge. . . . [I]f he actually believed in the existence of the fraud at the time he purchased the note, then it is immaterial how meager the facts may be which induced that belief.” See also *Paika v. Perry*, 225 Mass. 563, 114 N.E. 830 (1917).

19. 4 BOGERT, TRUSTS AND TRUSTEES § 892 (1935).

20. “Every one must conduct himself honestly in respect to the antecedent parties, when he takes negotiable paper, in order to acquire a title which will shield him against prior equities. While he is not obliged to make inquiries, he must not wilfully shut

The difficulty with this approach lies in the fact that it is a contradiction to state that rejection is the equivalent of receipt. Actually, the ultimate which rules of notice seek to establish is an awareness of legal conclusion predicated upon acquired knowledge. Therefore, the receipt of any material evidence or information which induces such belief makes immaterial the rejection of other facts which directly support such belief. This affirmative phraseology avoids the contradiction of the negative explanation and its dependency upon "bad faith."

Regardless of which approach is used, the important point which is established is that notice exists either when the facts received induce a belief in legal conclusion or when they are in themselves sufficient to permit the deduction of legal conclusion. Because bad faith is an attitude of mind resulting from a belief that a thing is invalid, it is apparent that if such belief is induced by reliable external evidence or information, then it is not only the basis for bad faith, but it is also notice.

This type of bad faith may be called "perceptive bad faith." The notice definition of the N.I.L. is merely a recognition of this fact.²¹ If the definition was restricted to "actual knowledge of the infirmity or defect," it could well be interpreted as not being satisfied unless all the facts which established the infirmity or defect were known to the purchaser. The addition of "or knowledge of such facts that his action in taking the instrument amounted to bad faith" recognizes that an awareness of invalidity as a legal conclusion, based on reliable fact, is also notice.

It must be emphasized that bad faith can exist independent of any notice aspect. If a belief or awareness of legal conclusion establishing invalidity is brought about purely by intuition, over-scrupulosity, ignorance, or mistake, then it is pure belief and not the equivalent of knowledge or notice. Such belief is properly labeled bad faith, yet it has no relation to notice. This type of bad faith may be called "intuitive bad faith," to distinguish it from the "perceptive bad faith" of notice.

Perceptive bad faith, on the other hand, has its basis in a belief which is well-grounded upon a knowledge of material facts. It is true that the knowledge which inspires such belief will not necessarily be sufficient in itself to establish notice objectively under the normal common law notice requirements because all the material facts may not be known. It is sufficient, however, to establish a belief founded in fact as distinguished from an unfounded belief. This founded-in-fact or perceptive belief in legal invalidity is the only type of belief which should be

his eyes to the means of knowledge which he knows are at hand. . . . [f]or the reason that such conduct, whether equivalent to notice or not, would be plenary evidence of bad faith." *Goodman v. Simonds*, 61 U.S. (20 How.) 934, 942 (1857).

21. *NEGOTIABLE INSTRUMENTS LAW* § 56.

recognized by negotiable instruments law as the basis for bad faith. *Legal bad faith in respect to the purchase of a negotiable instrument should, therefore, be defined as a belief by the purchaser that the instrument is invalid, which belief is justified by either his knowledge of facts which in law establish its invalidity or his knowledge of facts which if investigated would lead to such knowledge.*

It is apparent that the only difference between legal bad faith as defined above, and the common law concept of notice based upon knowledge of facts which would alert a reasonable man to investigate, is that a belief in legal invalidity based upon knowledge of such facts must exist in the purchaser before legal bad faith can be found, whereas a belief in legal invalidity is not necessary from the standpoint of notice. Under the actual knowledge standard of notice mere knowledge of such facts in itself will not establish notice. Nevertheless, notice can be proved from the fact that the purchaser consciously rejects and refuses to learn facts which in themselves permit the deduction of legal invalidity.

This conscious refusal or rejection can never be proved, however, unless it is first established that the purchaser has an actual belief at the time of purchase that the instrument is legally defective, invalid, or unenforceable. Furthermore, this belief must be based upon a knowledge of material facts which in themselves may not permit the deduction of such legal conclusion but, if investigated, would lead to the remaining necessary facts. Otherwise such belief is unfounded and without legal effect.

The conclusion that evolves from the above reasoning is that it is possible for a purchaser of a negotiable instrument to believe at the time of purchase that it is legally unenforceable or that its title is defective and still be a good faith purchaser in the eyes of the law. Such conclusion is possible if in defining good faith the same recognition is made of the legal ineffectiveness of intuitive bad faith as is made in defining legal bad faith. *Legal good faith in respect to the purchase of a negotiable instrument should therefore be defined as a belief by the purchaser that the instrument is valid; or a belief by the purchaser that its is invalid, which belief is unjustified by the facts known or presumed in law to be known by him.*

Under this definition of good faith, all that need be established for its proof is that the purchaser at the time he acquires the instrument has no actual knowledge of facts which in themselves establish a title defect or defense in law or no belief which amounts to legal bad faith. This leads to the further conclusion that good faith is synonymous with lack of notice and bad faith is synonymous with notice when notice is defined

as actual knowledge of facts establishing legal invalidity or actual knowledge of facts which establish legal bad faith. It is submitted that such is the case under the present N.I.L. notice definition. The important point to re-emphasize is that actual knowledge of facts which tend to establish legal bad faith is not sufficient to prove notice or legal bad faith in negotiable instruments law.²² It must be proved that such knowledge results in a belief that the instrument is legally unenforceable or defective in title.

The conflict which presently exists in negotiable instruments law concerning the proper standards for good and bad faith determinations stems in part from a failure to perceive that intuitive bad faith must be disregarded in any legal determination of the existence of bad faith. Once intuitive bad faith is considered as the equivalent of good faith, the application of a subjective standard in the determination of good or bad faith will at all times permit a just result in the individual case. Because this is the treatment given intuitive bad faith in the definitions of good and bad faith stated in the preceding paragraphs, it is submitted that their acceptance is the solution to the problem of applying the subjective standard in good and bad faith determinations.²³

22. In *Gerseta Corp. v. Wessex-Campbell Silk Co.*, 3 F.2d 236 (2nd Cir. 1924), the lower court refused to charge that, even if the plaintiff had no actual knowledge of the alleged diversion of the instruments in suit and even if it had no knowledge of any facts rendering it bad faith to take the instruments, yet, if under all the surrounding circumstances the jury did not think it acted in good faith, the verdict should be for the defendant. In affirming the lower court refusal, the court stated, ". . . bad faith under section 95 means that he must have knowledge of facts which render it dishonest to take the particular piece of negotiable paper under discussion. Knowledge, not surmise, suspicion, or fear is necessary; not knowledge of the exact truth, but knowledge of some truth that would prevent action by those commercially honest men for whom law is made; if we were all gentlemanly saints, law would be a simpler and quite different thing." *Id.* at 238.

The opinion leaves itself open to the interpretation that belief in invalidity is not necessary in the individual case as long as it can be proved that the holder had knowledge of such facts as would inspire a belief in a commercially honest man. Under this interpretation, the same result is accomplished for all practical purposes as was sought by the charge request refused by the trial court.

23. For the writer's criticism and rejection of the Proposed Uniform Commercial Code solution to the problem of good faith in negotiable instrument law, see Fagan, *Notice and Good Faith in Article 3 of the U.C.C.*, 17 U. PITT. L. REV. 176 (1956).

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