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NEGOTIABLE INSTRUMENTS—TRADE ACCEPTANCES—EFFECT OF REFERENCES TO EXTRANEOUS AGREEMENTS ON NEGOTIABILITY.—Action on a trade acceptance in the general form of a bill of exchange payable to order on a fixed date. The single question was whether the instrument was rendered non-negotiable by the addition of these words, "The obligation of the acceptor hereof arises out of the purchase of goods from the drawer, maturity being in conformity with the original terms of purchase." Held, the trade acceptance is negotiable within the meaning of the Negotiable Instruments Law. *State Trading Corp. v. Toepfert* (Mass. 1939), 23 N. E. (2d) 1008.

The issue presented in the principal case attracted considerable attention and great diversity of opinion in the period between 1922 and 1932 and only recently has it come before the courts again. The answer depends on whether the reference on the face of the instrument subjects the instrument to the terms of the extraneous agreement, thereby rendering it conditional and non-negotiable; or whether the reference is merely "a statement of the transaction which gives rise to the instrument," according to the Negotiable Instruments Law,[1] and thereby not affecting the negotiability of the instrument. The principle of law is clear; the courts have not been consistent in its application.

The first cases to arise involved only the first half of the statement as used in the principal case. This was the standard form prepared by the Federal

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purpose must be that of the master, not the servant. McDermott v. American Brewing Co. (1901), 105 La. Ann. 124, 29 So. 498.

[29] Grimes v. B. F. Saul Co. (1931), 60 App. D. C. 47, 47 F. (2d) 409. Caretaker of apartment house, upon pretense of collecting rent, entered plaitniff's room and assaulted her with intent to rape. The master was not liable. See also, Polk Sanitary Milk Co. (Ind. 1938), 17 N. E. (2d) 860.

[1] Mass. G. L. (Ter. Ed.), c. 107, sec. 25 (N. I. L., sec. 3(2)).

Reserve Board to make this type of paper eligible for rediscount purposes.[2] The Texas courts in a series of three decisions held this clause alone sufficient to destroy negotiability.[3] The great weight of authority, including subsequent Texas decisions,[4] is otherwise.[5] The Federal Reserve Board in response to the doubt cast by the Texas courts changed the standard form of the trade acceptance to read, "The transaction which gives rise to this instrument is the purchase of goods by the acceptor from the drawer."[6] But the uncertainty resulting from the Texas cases had done considerable damage to the postwar attempt of the Federal Reserve Board and other banking agencies to popularize the use of the trade acceptance in this country.

Although the courts are now unanimous in holding the short statement does not affect negotiability, there is a sharp conflict where the trade acceptance includes, as in the principal case, the additional words, "maturity being in conformity with the original terms of purchase." Three states have expressly distinguished the short statement from the present case and hold that the addi-

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[2] The trade acceptance enjoyed considerable use in this country prior to the Civil war and has long been an important part of the European credit system. The Federal Reserve Board believing in the advantages of this type of paper carried on an extensive educational program to popularize the use of the trade acceptance with the bankers and business men, but the program was not successful. See KEMMERER, THE ABC OF THE FEDERAL RESERVE SYSTEM (11th ed. 1938), p. 55 *et seq.*; THE AVAILABILITY OF BANK CREDIT, NAT. IND. CONF. BOARD, INC. (1932), p. 133.

The Federal Reserve Board in order to differentiate the trade acceptance from bills generally as respects the underlying transaction ruled, "A trade acceptance must bear on its face, or be accompanied by, evidence in form satisfactory to the Federal reserve bank, that it was drawn by the sellor of the goods on the purchaser of such goods. Such evidence may consist of a certificate on or accompanying the acceptance to the following effect: 'The obligation of the acceptor of this bill arises out of the purchase of goods from the drawer.'" Fed. Reserve Bd. Reg., Par. P, July 15, 1915.

[3] Lane v. Crum (Tex. Comm. of App. 1927), 291 S. W. 1084 (The trade acceptance in this case contained both clauses of the statement as in the principal case but the court based its decision primarily upon the first clause); Harris v. Wensche (Tex. Civ. App. 1928), 7 S. W. (2d) 595; Harris v. Bucek (Tex. Civ. App. 1928), 8 S. W. (2d) 565. These decisions placed the Texas courts in the anomalous position of holding an instrument non-negotiable which the Federal Reserve Board had specifically ruled eligible for rediscount. As opposed to this position, the court in Traders' Securities Co. v. Kalil (1932), 107 Pa. Super. 215, 162 A. 499, went so far as to say that: "It is not unreasonable to assume that the words were inserted to make the paper eligible for rediscount in a Federal Reserve Bank, rather than to suggest anything that created a necessity for inquiry."

[4] Arrington v. Mercantile Protective Bureau (Tex. Comm. of App. 1930), 24 S. W. (2d) 383 (The court expressly limited its decision in Lane v. Crum (Tex. Comm. of App. 1927), 291 S. W. 1084, to trade acceptances involving both clauses and held that the first half of the statement alone did not impair negotiability); American Exchange National Bank v. Steeley (Tex. Civ. App. 1928), 10 S. W. (2d) 1038.

[5] McCormick & Co. Bankers v. Gem State Oil & Products Co. (1923), 38 Idaho 470, 222 P. 286; Mercantile Protective Bureau v. Specht (1929), 58 N. D. 239, 225 N. W. 794; Coopersmith v. Maunz (1929), 227 App. Div. 119, 237 N. Y. S. 1; Johnston v. Wolf (1931), 118 Cal. App. 388, 5 P. (2d) 673; Traders' Securities Co. v. Kalil (1932), 107 Pa. Super. 215, 162 A. 499; Bartoshesky v. Houston Trading Corp. (Del. 1938), 198 A. 697.

[6] FEDERAL RESERVE BULLETIN (1927), p. 510.

tional clause renders the trade acceptance non-negotiable.[7] The argument presented is that the clause reasonably carries notice to a third person that he must look to the underlying agreement to determine the maturity of the instrument, otherwise the clause is mere surplusage. Once this position is taken, the question is raised as to what effect this duty of inquiry has upon the instrument; i. e., whether the instrument becomes absolutely non-negotiable or whether it becomes conditional on its face and may become unconditional when proper inquiry does not reveal any conditions affecting maturity in the underlying agreement.[8] The latter alternative seems even more objectionable as placing too great a burden on the free circulation of the trade acceptance.

As opposed to this line of reasoning several cases acknowledge that the clause on the face of the instrument does notify the third person of an underlying agreement, but such notification has no more effect than knowledge acquired otherwise.[9] And mere knowledge of an extraneous agreement does not impair negotiability as long as there is no knowledge of breach.[10]

It would seem there is no real validity to the argument that the clause makes maturity uncertain, since on its face the trade acceptance becomes due and payable on an exact date. To hold otherwise would be to contradict the instrument directly. The court in the principal case explains the incorporation of the statement into the trade acceptance on the ground that this particular instrument should "carry on its face an assurance both that it had its origin in a genuine commercial transaction and that there had been no extension of the original term of credit." In the light of the comparative ease of making an instrument expressly non-negotiable, it is not unreasonable to believe that the parties did not intend for their instrument to be adjudicated non-negotiable by the inclusion of this incidental provision.

The two opposing lines of thought can not be rationalized. The question is resolved into one of policy. The principal case and a recent New York decision[11] in accord would seem to indicate a present willingness to favor

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[7] Lane v. Crum (Tex. Comm. of App. 1927), 291 S. W. 1084, as explained and limited by Arrington v. Mercantile Protective Bureau (Tex. Comm. of App. 1930), 24 S. W. (2d) 383; Westlake Mercantile Finance Corp. v. Merritt (1928), 204 Cal. 673, 269 P. 620, 61 A. L. R. 811; First National Bank v. Power Equipt. Co. (1930), 211 Iowa 153, 233 N. W. 103. But contra: Heller v. Cuddy (1927), 172 Minn. 183, 214 N. W. 925.

[8] In the California, Texas (Lane v. Crum), and Iowa decisions (*supra*, note 7), holding against negotiability, there did not appear to be conditions affecting the maturity of the trade acceptances in the underlying agreements. The California court seemed to support the theory of absolute non-negotiability in quoting a statement from the Texas decision, "The legal effect of the clause is to render the paper subject to all rights and equities of the parties to the collateral transaction from which the acceptance of the obligor arises." But the Iowa case is not clear upon the point. The court to support its conclusion resorted to a hypothetical in which the underlying agreement did contain a condition affecting maturity, a renewal clause. The court said this would make the instrument non-negotiable but didn't make clear its position where the underlying agreement contained no conditions affecting the maturity of the trade acceptance.

[9] See Mercantile Protective Bureau v. Specht (1929), 58 N. D. 239, 225 N. W. 794; Wakem v. Schneider (1927), 192 Wis. 528, 213 N. W. 328.

[10] Mercantile Protective Bureau v. Specht (1929), 58 N. D. 239, 225 N. W. 794; Mountjoy Parts Co. v. San Antonia National Bank (Tex. Civ. App. 1928), 12 S. W. (2d) 609.

[11] State Trading Corp. v. Smaldone (1938), 15 N. Y. S. (2d) 33.

negotiability. The trade acceptance has not achieved wide usage in this country in spite of the many advantages claimed for it by banking agencies. It is submitted that this type of paper can be given a fair chance only by the cooperation of the courts in holding with the principal case that the contested provision is a mere statement of the transaction which gives rise to the instrument and does not affect its negotiability.

W. S. H.

PROCEDURE OR SUBSTANCE—BURDEN OF PROOF—ERIE V. TOMKINS AND THE NEW FEDERAL RULES.—Plaintiff, purchaser from defendants' vendee, sued to remove cloud on title to land. Because of diversity of citizenship the federal district court had jurisdiction. The defendants filed a cross-bill alleging a mistake in the insertion of a call in the deed which conveyed more land than intended and alleging that the metes and bounds was the correct description. The plaintiff denied the mistake and alleged that it was a bona fide purchaser for value without notice. The federal court applied the federal rule placing the burden of proving bona fide purchase on the party asserting this. The plaintiff asserted that the Texas rule which placed the burden on the party asserting an equitable title against the legal record owner should be applied. The district court held that this was only a matter of procedure and followed the federal rule, and was sustained by the circuit court of appeals. Held, reversed. The burden of proof is a substantive matter and under *Erie v. Tomkins*[1] the federal courts must follow the state rule. *Cities Service Oil Co. v. Dunlap* (1939), 60 S. Ct. 201.

Whether a rule is substantive or procedural may depend upon the purpose for which the distinction is made.[2] There have been many decisions on this matter[3] but the present case arises in a new field as a result of *Erie v. Tomkins*. Classically burden of proof is a part of remedial law and the law of evidence and is procedural.[4] Occasionally the rules as to burden of proof have been given almost a substantive meaning but it has seldom been necessary in carrying out the purpose for which the classification was made to actually decide that burden of proof was anything but procedural.[5] Conflicts of law cases are

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[1] Erie v. Tomkins (1938), 304 U. S. 64, 58 S. Ct. 819. The federal courts must follow state court decisions as to substantive law in diversity of citizenship cases as well as state statutes.

[2] Cook, *"Substance and Procedure" in the Conflicts of Laws* (1933), 42 Yale L. Jl. 333, 337. "If once we recognize that the 'line' (between substance and procedure) can be drawn only in the light of the purpose in view, it cannot be assumed that as our purpose changes the line can be drawn precisely at the same point."

[3] Sackheim v. Pigueron (1915), 215 N. Y. 62, 109 N. E. 109; Southern Ind. Ry. Co. v. Peyton (1901), 157 Ind. 690, 61 N. E. 722.

[4] "Procedure is the machinery for carrying on the suit, including pleading, process, evidence, and practice whether in the trial court or the appellate court, or in the processes by which cases are carried to appellate courts for review, or in laying the foundation for such review." Jones v. Erie R. R. Co. (1923), 106 Ohio St. 408, 140 N. E. 360. "Substance is that part of the law which creates, defines and regulates rights, as apposed to *adjactive* or remedial law, which prescribes the method of enforcing rights or obtaining redress for their invasion." Anderson v. Wirkmon (1923), 67 Mont 176, 215 P. 224.

[5] Midland v. Martin (1935), 100 Ind. App., 194 N. E. 862; *cf.* Helton v. Alabama R. R. Co. (1893), 97 Ala. 278, 12 So. 276; Jones v. Chi. R. R. Co.