Indiana Law Journal

Volume 13 | Issue 3 Article 5

2-1938

Cognovit Notes-Collateral Security

RECENT CASE NOTES

COGNOVIT NOTES—COLLATERAL SECURITY.—Plaintiff seeks to foreclose a real estate mortgage given by the defendant as security for certain promissory notes which contained a provision irrevocably authorizing any attorney to confess judgment in any court without service of process. The trial court refused to allow foreclosure of the mortgage on the ground that since cognovit notes are

invalidated by statute in Indiana, the accompanying mortgage must also fail. Plaintiff appealed to the Supreme Court. HELD: The mortgage and cognovit clause were distinct transactions, and the illegal cognovit clause could be separated from the valid acts of the parties so that the mortgage is enforceable.[1]

At common law[2] and by statute[3] most states have taken the position that a person can waive his right to service of process in the interest of expediting justice. However, Indiana and a few other states at common law refused to allow judgments taken under such a power of attorney to stand on the theory that it is against public policy to permit a defendant to bargain away his right to be heard and to take no day in court.[4] The legislatures which have refused to sanction this practice have usually passed statutes whose only effect is to invalidate the clause conferring power of attorney, and the instrument remains enforceable according to the ordinary processes of the law.[5] The Indiana statutes stand alone in not only avoiding the entire note but in declaring penal liabilities against anyone who makes, endorses, or attempts to enforce a cognovit note.[6]

It is interesting to note how the Indiana courts, in deciding the few cases which have thus far arisen regarding the application and interpretation of the statutes, have attempted to cut down their drastic language by, in effect, producing no greater penalty than that which results in states where only the cognovit clause is invalidated, and the note itself can be enforced.

In *Fodor v. Popp*[7] the court said that a promissory note containing blanks at the time of delivery which, if filled, would make it a cognovit note, cannot,

---

[1] Peoples National Bank & Trust Co. et al. v. Pora et al. (Ind. 1937), 9 N. E. (2d) 83.

[2] Cross v. Moffat (1888), 11 Colo. 210, 17 P. 771; Saunders v. Lipscomb (1804), 90 Va. 647, 19 S. E. 450; Hutchinson v. Palmer (1906), 147 Ala. 517, 40 So. 339; Hazel v. Jacobs (1909), 78 N. J. L. 459, 75 A. 903, 27 L. R. A. (N. S.) 1066.

[3] Little v. Dyer (1891), 138 Ill. 272, 27 N. E. 905; Mason v. Ward (1907), 80 Vt. 290, 67 A. 820; Vennum v. Holmberg (1911), 51 Colo. 306, 117 P. 169; Moe v. Schaffer (1921), 150 Minn. 114, 184 N. W. 785; Ann. Cas., 1914 A. 645.

[4] Irose v. Balla (1914), 181 Ind. 491, 104 N. E. 851; Egley v. T. B. Bennett & Co. (1924), 196 Ind. 50, 145 N. E. 830; 40 A. L. R. 436; Farquhar v. Dehaven (1912), 70 W. Va. 738, 75 S. E. 65; First National Bank v. White (1909), 220 Mo. 717, 120 S. W. 36, where the court said: "The so-called authorization would certainly not be recognized as valid under the laws of this state . . . because it is against the policy of our law to permit a man, when entering into an obligation, to bargain away his right to be heard in court, should a question ever arise between him and his adversary in relation to it."

[5] Hendrickson v. Fries (1883), 45 N. J. L. 555; Aultman v. Mead (1901), 109 Ky. 583, 60 S. W. 294; Jemison v. Freed (1909), 161 Ala. 598, 50 So. 52; Carroll v. Gore (1932), 106 Fla. 582, 143 So. 633. Sec. 4495, C. G. L. (1927) of Florida provides: "All powers of attorney for confessing or suffering judgment made or to be made by any person whatsoever in this state, before such action brought, shall be null and void."

Freeman, Judgments, (5th ed. 1925), § 1302; 15 R. C. L. 648. For an excellent discussion of this problem see Ann. Cas. 1914 A, 647.

[6] Sec. 2-2904, Burns' 1933, after declaring it illegal to execute or procure to be executed a written instrument containing a warrant of attorney to confess judgment without service of process says, "Any and all contracts, stipulations and powers of attorney given or entered into before a cause of action on such promise to pay shall have accrued, shall be void." Sec. 2-2906 defines a cognovit note and prescribes the penalty for its execution or attempt at enforcement.

[7] (1931), 93 Ind. App. 429, 178 N. E. 695; Discussed in 7 Ind. L. J. 447.

in absence of evidence that parties, when the note was signed, gave authority for filling blanks, be construed as a cognovit note and hence invalid. In other words the court adopted the more liberal and commercially expedient rule that words would not be supplied by construction which would make the note void, and that it is not to be presumed that the intention was to execute an instrument that could not be enforced. A strong argument could be made for the opposite result on the theory that when blanks are left in a promissory note at the time of its delivery, the holder has the implied authority to fill in such blanks, and that on failure to do so the instrument will be read and construed as though the blanks were filled in comformable to the text of the instrument.[8]

In *Phend v. Midwest Engineering Co.*,[9] although the purchaser under a conditional sales contract executed cognovit notes for part of the purchase price, the court allowed such contract to be enforced on the theory that the contract and the cognovit notes were distinct transactions, and that the illegal cognovit clause contained in the notes could be separated from the valid acts of the parties. The court recognized the rule that instruments executed at the same time, by the same parties, and for the same purpose, in the eyes of the law were one instrument and should be read together;[10] but held that rule, as applicable to the existing facts, did not make the conditional sales contract void.

The principal case involved a problem somewhat similar to the Phend case, and the court applied analogous reasoning in reaching the conclusion that a mortgage given to secure invalid cognovit notes is a separate and distinct instrument, although executed simultaneously with the notes and concerning the same matters. A reading of our cognovit note statutes does not reveal what the legislative intent was regarding enforcement of the original contract or of collateral security, but the court reached a very desirable construction when it said, "It is clear that the purpose of the statute is to prevent judgments to be taken without the service of process and by virtue of a power of attorney executed in advance. It is not the purpose of the statute to enable a person to escape the payment of an honest debt."

Our decisions throw no light on the subject of why the Indiana legislature went one step further than other states so as to make the cognovit note void. The general tenor of the statutory language would indicate that a severe penalty is intended. If such is the case, the courts are doing their best to mitigate the hardship of the creditor by allowing him to resort to the enforcement of the original contract or to foreclosure of collateral security. If the courts are endeavoring to prevent the escape from payment of an honest debt, the courts might extend their liberal tendency to allow a recovery of the debt itself in indebitatus assumpsit.[11]

---

8 Sec. 14 of Uniform Negotiable Instruments Act, Burns' 1933, sec. 19-114.

9 (1931), 13 Ind. App. 165, 177 N. E. 879.

10 6 R. C. L. § 240, p. 850.

11 Compare the situation which exists when by statute a usurious note is declared void, and it has been given for a pre-existing valid debt. In Rice v. Welling (1830), 5 Wend. (N. Y.) 595, the court said, "The power relates wholly to the contract and makes that utterly void; but if there was once a valid subsisting debt, that cannot be destroyed by a void or invalid security." See also Silverstein v. Taubenkimmel (1924), 205 N. Y. S. 241; 66 C. J. p. 243.

Our policy of forbidding the execution of cognovit notes can be sufficiently realized by the invalidation solely of the cognovit feature. Although the Supreme Court through circumvention has reached a very desirable interpretation, it might be advisable for the legislature to make our statutes analogous to those which invalidate only the warranty of attorney to confess judgment without service of process, and which thus leave the note itself enforceable by the customary methods of procedure. This would tend to secure uniformity in interstate commercial transactions,[12] and to settle moot questions not yet decided such as what might be the result if the original contract provided for the giving of cognovit notes, or if the mortgage also contained a cognovit clause.[13]

H. J. B.

SURETYSHIP—SUBROGATION—EFFECT OF RELEASE OF SURETY AFTER PARTIAL SATISFACTION—Plaintiff and the Bank entered into an agreement with relation to the preferred stock of the Realty Company by which the Bank purchased the stock as trustee and the plaintiff guaranteed the payment of dividends as well as redemption of the stock as provided by the stock agreement. Later, in order to raise money for repairs, a reorganization of the Realty Company was affected. As part of the reorganization plan plaintiff was released from all further liability on his guaranty. He had already paid $15,000 to the company to be used in payment of dividends and in retirement of the stock. When the Realty Company went into the hands of a receiver, plaintiff filed a claim for the money advanced, claiming to be subrogated to the rights of the preferred stockholders whose stock had been retired with the money advanced. Held: plaintiff was not entitled to the preference which the stockholders had on dissolution.[1]

The first question arising involves the effect of the contract of guaranty in the first instance. On this point it is generally held that such contracts of guaranty are valid and can be enforced with the limitation that the guaranty must be by a third person[2] and not by the corporation itself.[3] If the guaranty is made by the corporation itself, it is denied effect; for it is contrary to public policy for a corporation to pay dividends except out of earnings, and a

---

12 "The Cognovit Note Act," by G. A. Farabaugh and Walter Arnold, 5 Indiana L. Jl. 93; "The Indiana Cognovit Note Statute," by Bernard C. Gavit, 5 Indiana L. Jl. 208.

13 In Phend v. Midwest Engineering Co., the court merely said, "There is no stipulation in the conditional-sales contract that the several promissory notes were to contain the usual terms and conditions of a cognovit or judgment note."

In the principal case the court said, "There is no stipulation in the mortgage that the note given as evidence of the debt should contain the cognovit feature."

1 Ellis v. Thompson (1937), 8 N. E. (2d) 430, Indiana Appellate Court.

2 Austin v. Wright (1930), 156 Wash. 24, 286 P. 48; McCampbell v. Obear (1915), 27 Cal. App. 97, 148 P. 942; Scholbe v. Schuchardt (1920), 292 Ill. 529, 127 N. E. 169; Hornor v. McDonald (1899), 52 La. Ann. 396, 27 So. 91; Rogers v. Burr (1898), 105 Ga. 432, 31 S. E. 438.

3 In some cases a guaranty by the corporation is construed, not as being void, but merely to mean that the dividends are cumulative; Prouty v. Michigan Southern Ry. Co. (1874), 1 Hun. (N. Y.) 655; Boardman v. Lake Shore Ry. Co. (1881), 84 N. Y. 157; Lockhart v. Van Alstyne (1875), 31 Mich. 76.