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Suretyship Defenses by Co-Makers in Missouri Since the Negotiable Instruments Law

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a transfer tax may not be levied by a state having jurisdiction only of the person exercising a power of appointment, but not of the property, its trustee, or the person or instrument creating the power.[103] A trustee is not taxable by the state of his domicil on trust property outside the state, if he does not act as trustee within the state.[103a]

QUESTIONS NOT BETWEEN STATES.

As between taxing districts within a state the legislature may fix the situs of property for tax purposes at its discretion;[104] so cases involving that problem solely need not be specifically considered.

Whether the same rules as to situs which are applicable to state taxes apply also to federal taxation of property not in the United States, or belonging to non-resident aliens, the few decisions involving the question do not answer conclusively. An early case indicating that they do apply[105] was reversed on a ground which did not involve that question.[106] In *United States v. Bennett*[107] the court said that the restriction of the taxing power of the states to subjects within their jurisdiction does not apply to the United States, and sustained a federal tax on the use by a resident citizen of a yacht never in the United States. But this result could have been reached on the rule of taxation of vessels at the owner's domicil as applied to state taxation,[108] and in a later case[109] the court gave as a ground for upholding a federal tax on the income of an alien from stocks, bonds, etc., that the property was localized in the United States,—indicating that some ground of jurisdiction was thought necessary. Probably the most that *United States v. Bennett, supra,* should be taken as establishing, is that the doctrine of constructive situs is applicable to federal taxation.

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SURETYSHIP DEFENSES BY CO-MAKERS IN MISSOURI SINCE THE NEGOTIABLE INSTRUMENTS LAW

I.

Before the adoption of the uniform Negotiable Instruments Law by the Missouri Legislature in 1905, it had become unquestionably estab-

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[103] Wachovia Bank & Trust Co. et al. v. Doughton, Adv. Ops. U. S. Sup. Ct. Dec. 15, 1926, p. 250.

[103a] Goodsite v. Lane et al., 139 F. 593 (1905).

[104] State Railroad Tax Cases, 2 Otto 575, 23 L. ed. 663 (1876); Columbus Southern R. Co. v. Wright, 151 U. S. 470, 14 Sup. Ct. 396, 38 L. ed. 238 (1894); Adams Exp. Co. v. Ohio St. Auditor, 165 U. S. 194, 17 Sup. Ct. 305, 41 L. ed. 683 (1897); Diamond Match Co. v. Village of Ontonagon et al., 188 U. S. 82, 23 Sup. Ct. 266, 47 L. ed. 394 (1903).

[105] U. S. v. Erie R. Co., 9 Ben. 67, Fed. Cas. No. 15,056 (1877).

[106] 16 Otto 327, 27 L. ed. 151 (1882).

[107] 232 U. S. 299, 34 Sup. Ct. 433, 28 L. ed. 612 (1914).

[108] See *supra*, page 4.

[109] DeGanay v. Lederer, 250 U. S. 376, 39 Sup. Ct. 534, 63 L. ed. 1042 (1919).

lished in this state by a long series of judicial decisions that accommodation co-makers were to be regarded as sureties, and were entitled to all the rights and immunities conferred upon sureties by the broad principles of suretyship law.[1] One of these principles was to the effect that the making of a binding agreement between the creditor and the principal debtor, whereby the creditor for a valuable consideration agreed to an extension of the time for payment of the debt without the consent of the surety, operated to release the surety from his obligation.[2] Others related more particularly to situations where the principal debtor had placed in the hands of the creditor collateral security for the debt. Because of his rights to be subrogated to such security upon payment of the debt, the surety was held to have an interest in every lien or remedy held by the creditor; the latter was regarded as in a sense a trustee for the surety,[3] and was not permitted to release or voluntarily destroy any of these securities. If the creditor did actually destroy or release any remedies which he possessed as against the principal debtor, or returned security to the debtor or applied it to other purposes than the payment of the secured debt, the surety was by that fact discharged *pro tanto,* because of the loss of his subrogation rights.[4] It is the reliance upon these rules of suretyship law by co-makers which the writer has denominated "suretyship defenses by co-makers"; and it is with the status of these defenses under the provisions of the Negotiable Instruments Law that the present note is concerned. First, we shall consider the situation with reference to suits by payees, and then as concerns the rights of holders other than payees.

II.

The following are those sections of the statutes which are involved in the question now under consideration:—

> Sec. 816, R. S. Mo. 1919; uniform N. I. L. Sec. 29: An accommodation party is one who has signed the instrument as a maker, drawer, acceptor, or endorser, 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.

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[1] English v. Seibert, 49 Mo. A. 563; Noel v. Oberhellman, 20 Mo. A. 336; Mechanics' Bank v. Wright, 53 Mo. 153; Hardester v. Tate, 85 Mo. A. 624.

[2] Noel v. Oberhellman, 20 Mo. A. 336; Fisher v. Stevens, 143 Mo. 181, 44 S. W. 769; Johnson v. Franklin Bank, 173 Mo. 171, 73 S. W. 191; Westby v. Stone, 112 Mo. A. 411, 87 S. W. 34.

[3] Lower v. Buchanan Bank, 78 Mo. l. c. 71; State Bank v. Bartle, 114 Mo. 276, 21 S. W. 816; Colebrooke on Collateral Securities (2d ed.) Sec. 239.

[4] Brandt on Suretyship and Guaranty (3d ed.) Sec. 480; 21 R. C. L. 1053; Rice v. Morton, 19 Mo. 263, l. c. 280; Taylor v. Jeter, 23 Mo. 244; Priest v. Watson, 75 Mo. l. c. 315; English v. Seibert, 49 Mo. A. 563; Brown v. Bank, 112 Fed. 901; Lakenan v. North Missouri Trust Co., 147 Mo. A. 48, 126 S. W. 547; Troll v. Daugherty & Bush R. E. Co., 186 Mo. A. 196, 171 S. W. 665.

Sec. 817; uniform act Sec. 30: An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. If payable to bearer it is negotiated by delivery; if payable to order it is negotiated by the indorsement of the holder completed by delivery.

Sec. 838; uniform act Sec. 52: 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.

Sec. 844; uniform act Sec. 58: In the hands of any holder other than the holder in due course, a negotiable instrument is subject to the same defenses as if it was non-negotiable. But a holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect of all parties prior to the latter.

Sec. 905; uniform act Sec. 119: A negotiable instrument is discharged: (1) by payment in due course by or on behalf of the principal debtor; (2) by payment in due course by the party accommodated, where the instrument is made or accepted for accommodation; (3) by the intentional cancellation thereof by the holder; (4) by any other act which will discharge a simple contract for the payment of money; (5) when the principal debtor becomes the holder of the instrument at or after maturity in his own right.

Sec. 906; uniform act Sec. 120: A person secondarily liable on the instrument is discharged: (1) by any act which discharges the instrument; (2) by the intentional cancellation of his signature by the holder; (3) by the discharge of a prior party, except when such discharge is had in bankruptcy proceedings; (4) by a valid tender of payment made by a prior party; (5) by a release of the principal debtor, unless the holder's right of recourse against the party secondarily liable is expressly reserved; (6) by an agreement binding upon the holder to extend the time of payment or to postpone the holder's right to enforce the instrument; unless made with the assent of the party secondarily liable, or unless the right of recourse against such party is expressly reserved.

Sec. 981; uniform act Sec. 192: The person primarily liable on an instrument is the person who by the terms of the instrument is absolutely required to pay the same. All other parties are secondarily liable.

III.

The first Missouri case after the adoption of the Negotiable Instruments Law in which a suretyship defense was pleaded was *Lane v. Hyder.*[5] To Lane's cause of action on the note signed by H. Hyder and J. Hyder, the latter pleaded his discharge by reason of his being surety on the note and of the fact that plaintiff and H. Hyder had made an agreement for an extension of time for payment, based on a valuable consideration. The Court conceded that before the Negotiable Instruments Law this defense would have been good, but held that this law abrogated said defense, for by Sec. 10161, R. S. 1909,[6] defendant was primarily, rather than secondarily, liable, and extension of time releases a party only when primary liability does not exist. The opinion was able to cite many cases from foreign jurisdictions in its support.[7] This decision was followed by the St. Louis Court of Appeals in the case of *Citizen's Bank of Senath v. Douglass,*[8] which says: "Those, who sign as joint makers and therefore 'by the terms of the instrument' are absolutely required to pay the same, are by the statute made 'persons primarily liable,' and, therefore, none of them will be permitted to show that they signed as sureties merely, and hence none of them will be released by an extension of time." The Court's belief in the soundness of its holding was reiterated in *Night & Day Bank v. Rosenbaum.*[9] In effect, the reasoning of the three decisions is as follows: Sec. 816, R. S. 1919,[10] makes the accommodation maker liable to a holder for value. By Sec. 981[11] a maker is primarily liable on the note. Therefore Sec. 905,[12] rather than Sec. 906,[13] controls the discharge of his liability, and under it he is not discharged. This reasoning is in accord with the general weight of authority interpreting the Negotiable Instruments Law, but is not law in Missouri today.[14]

The Springfield Court of Appeals was first confronted with this question in 1917 in the case of *Long v. Shafer,*[15] a suit by the payee of a note against the makers. All the defendants excepting Mason defended on the ground that Mason alone had received the consideration for the note and the others had signed merely as sureties for him, that he had given plaintiff Long a deed of trust on 184 acres of land as security for the note, and that Long had released 57 acres from the lien of this deed at Mason's request, without consulting his co-makers,

[5] 163 Mo. A. 688, 147 S. W. 514 (K. C. Ct. Ap., 1912).

[6] R. S. Mo. 1919, Sec. 981; uniform N. I. L., Sec. 192.

[7] Richards v. Market Exchange Bank, 81 Oh. St. 348, 90 N. E. 1000, 26 LRANS. 99; Vanderford v. Farmers' Bank, 105 Md. 164, 66 A. 67, 10 LRANS. 129; Bradley Eng. Co. v. Heyburn, 56 Wash. 628, 106 P. 170; Wolstenholme v. Smith, 34 Utah 300, 97 P. 329.

[8] 178 Mo. A. 664, l. c. 689 (1913), 161 S. W. 601.

[9] 191 Mo. A. 559, 117 S. W. 693, l. c. 696. This case is discussed in 8 St. Louis Law Review 39, re accommodation indorsers. See also, as following Lane v. Hyder, Citizens' Nat. Bank v. Rombauer, 194 Mo. A. 690, 189 S. W. 651 (K. C. Ct. Ap., 1916).

[10] Uniform N. I. L. Sec. 29.

[11] Uniform N. I. L. Sec. 192.

[12] Uniform N. I. L. Sec. 119.

[13] Uniform N. I. L. Sec. 120.

[14] See 48 A. L. R. 715; Brannan's Neg. Inst. Laws (4th ed.) 361.

[15] 185 Mo. A. 641, 171 S. W. 690.

who were consequently discharged *pro tanto* by Long's destruction of the security which had induced their signing of the note. The plaintiff acknowledged that under the law prior to the Negotiable Instruments Law "it was competent to show by parol evidence that one who signed a negotiable instrument ostensibly as maker signed as a surety, and that the holder had knowledge of the fact, and that upon these facts and proof that * * * the holder held any property of the principal to secure the note, or other security for its payment, and without the assent of the surety gave up such property or released the other security, the surety was discharged to the extent of the property surrendered or the security released," but contended that this defense was unavailable under the Negotiable Instruments Law, according to the reasoning outlined *supra*. But the Court, by a vote of two judges to one, reached a contrary conclusion to that of the other appellate courts, on the following theory: R. S. 1909, Sec. 10001[16] defining negotiation, contains no provision which refers to the delivery of the instrument by the maker to the payee; Sec. 10022[17] stating the essential attributes of a 'holder in due course' implies the necessity of a negotiation to him, and therefore no payee can be a holder in due course; Sec. 10028[18] makes a negotiable instrument in the hands of one not a holder in due course subject to the same defenses as if it were non-negotiable; consequently, for the purposes of the instant case, the defense was a valid one. The Court refused to impute to the legislature an intent to change the pre-existing rights of a surety without expressly so stating. The opinion states:—

> A note as between the original parties is like any other simple contract.
>
> In the hands of the holder other than in due course commercial paper is subject to the equities existing between the original parties. To hold otherwise is to deny parties, as between themselves, the right to contract concerning matters nowise unlawful.

As stated above, this decision of the Court was not concurred in by one member thereof (Sturgis, J., delivered an able dissenting opinion). Because of this and in view of the sharp conflict between this decision and views of the other Courts of Appeal, as expressed in *Lane v. Hyder, supra,* and *Citizen's Bank v. Douglass, supra,* the case was certified to the Supreme Court. Being confronted with these two contrary rulings, and at liberty to choose either, that body, under the style of *Long v. Mason,*[19] expressly approved and adopted the holding in *Long v. Shafer* and thus overruled the other two cases. In this connection, it should be noted that the opinion of the Court is not the opinion of Railey, C., but

[16] R. S. Mo. 1919, Sec. 817, uniform N. I. L. Sec. 30.
[17] R. S. Mo. 1919, Sec. 838, uniform N. I. L. Sec. 52.
[18] R. S. Mo. 1919, Sec. 844, uniform N. I. L. Sec. 58.
[19] 273 Mo. 266, 200 S. W. 1062.

that of Williams, J., concurring.[20] Based on the reasoning of *Vander Ploeg v. Van Zuuk,*[21] it was held that plaintiff was not, and as payee, could not be, a holder in due course, for those words imply a negotiation to the holder, and preclude the possibility of his being the original owner and possessor. Since Long was no holder in due course, the note was subject to the same defenses as if it were non-negotiable and parol evidence was admissible to prove defendant's suretyship and consequent discharge by the creditor's release of security. One member of the Court (Bond, J.) dissented from this decision, and one other did not participate therein.

This Long case has been followed on all points involved by subsequent Missouri decisions. Among these which involve the rule denying the right of the payee to be considered a holder in due course are *Atkinson v. Kelly,*[22] saying, "Since the action is here between the immediate parties whose names appear upon the instrument, the case is governed by the rules applicable to non-negotiable instruments"; *St. Charles Sav. Bank v. Edwards,*[23] holding that a holder in due course must be one to whom the paper has been negotiated by indorsement by the payee or a prior indorser; *Martinsburg Bank v. Bunch et al.;*[24] *Schelp v. Nicholls;*[25] *People's State Bank of Hartsville v. Hunter;*[26] *Farmers' State Bank v. Schelin,*[27] which states, "We must proceed without reference to the Negotiable Instruments Law. This suit is between the original parties to the note, and hence all defenses that would be open to defendants on any other form of written contract are open to them in this case"; *Weller v. Meadows,*[28] holding that "to be a holder in due course the holder must have acquired the note by negotiations, and transfer from the payee, or prior indorsee, and not by issue or delivery from the maker"; and, as recently as Apr. 11, 1927, *Gate City Nat. Bank v. Bunton,*[29] wherein the Court recognizes that its decision is in non-conformity with majority rule and makes the following statement:

> There is great conflict of decision as to whether the payee of a negotiable promissory note may, under the Negotiable Instruments Law, be a holder in due course. Brannan's Negotiable Instruments Laws (4th ed.) 361. The question was answered in the negative by the Springfield Court of Appeals in *Long v. Shafer,* 185 Mo. A. 641, 171 S. W. 690, and its holding was approved by this court

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[20] That this is the fact has been judicially recognized in Newkirk v. Hays, 275 S. W. 964.
[21] 135 Iowa 350, 112 N. W. 807.
[22] 214 S. W. 276, l. c. 280 (St. L. Ct. Ap., 1919).
[23] 243 Mo. 553, 147 S. W. 978 (1912). This case, although not mentioning the N. I. L., was decided after its enactment.
[24] 212 Mo. A. 249, 251 S. W. 742 (St. L. Ct. Ap., 1923).
[25] 263 S. W. 1017 (St. L. Ct. Ap., 1923).
[26] 216 Mo. A. 334, 264 S. W. 54 (Sprfld. Ct. Ap. 1924).
[27] 264 S. W. 427, l. c. 429 (Sprfld. Ct. Ap., 1924).
[28] 272 S. W. 85 (K. C. Ct. Ap., 1925). [29] 296 S. W. 375 (Mo. Sup.)

in *Long v. Mason,* 273 Mo. 266, 200 S. W. 1062. Upon further consideration we are not disposed to depart from the ruling there made.

Concerning particularly the rule that parol evidence is admissible to show that a co-maker received no consideration for his signature which fact was known to the payee, wherefore the co-maker is to be considered a surety, the Long cases are supported by *Producers' State Bank v. Danciger et al.*[30] and *Bank of Neelyville v. Lee.*[31] The Long case was itself, of course, concerned with that type of suretyship defense by a co-maker in which he alleges that the creditor has injured or destroyed the surety's subrogation rights. Later cases of this type are *Martinsburg Bank v. Bunch and Boillot;*[32] *People's Bank of Ava v. Baker;*[33] *St. Louis Union Trust Co. v. Laughlin;*[34] and *Schelp v. Nicholls.*[35] The last three of these cases were actions against indorsers, but they may be cited here as authority inasmuch as, for the purposes of those cases, the indorser who signed before delivery would apparently have been held to be under the primary liability of an accommodation co-maker according to the Negotiable Instruments Law.

Despite the fact, pointed out in *German American State Bank v. Weston,*[36] that release of a surety by a valid and binding agreement for the extension of time for payment and his release by reason of a creditor's destruction or loss of securities upon the debt, do not rest upon the same basis of reasoning, they may and should both be classed together as suretyship defenses. Therefore, the courts have accepted and applied the decision in *Long v. Mason, supra,* in its full effect to cases where accommodation co-makers plead as defense the entrance by creditor and debtor without his consent into a valid agreement for the extension of time. See *People's Bank of Chamois v. Smith,*[37] and *Newkirk v. Hays et al.,*[38] the latter of which expressly recognizes the fact that *Long v. Mason, supra,* overruled the early trend of the cases led by *Lane v. Hyder, supra,* and re-established to pre-Negotiable Instruments Law.

Thus it may be seen that without question the doctrine of *Long v. Mason, supra,* is the firmly established law of Missouri. However, as pointed out in the Annotation in 48 A. L. R. 715, 725, this is the minority rule in this country, both on the general proposition that the Negotiable Instruments Law does not abrogate prior defenses based on suretyship and the more specific proposition that the payee cannot possibly "hold in due course." But, lest it appear that Missouri stands absolutely alone in its position on the matter, see the cases of *Fullerton Lumber Co. v. Snouffer,*[39] *Howth v. J. I. Case Threshing Mach. Co.,*[40] and *Exum v. Mayfield.*[41]

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[30] 218 Mo. A. 39, 264 S. W. 1000 (K. C. Ct. Ap., 1924).
[31] 208 S. W. 143 (Sprfld. Ct. Ap., 1919).
[32] See footnote 3.
[33] 193 S. W. 632 (Sprfld. Ct. Ap.).
[34] 254 S. W. 844 (Mo. Sup).
[35] 263 S. W. 1017 (St. L. Ct. Ap.).
[36] 99 Kan. 686, 163 P. 637.
[37] 263 S. W. 475 (K. C. Ct. Ap., 1924).
[38] 275 S. W. 964 (K. C. Ct. Ap., 1925).
[39] 139 Iowa 176, 117 N. W. 50.
[40] 280 S. W. 238 (Tex. Civ. App.).
[41] 297 S. W. 607 (Tex. Civ. App.).

Since it has been decided that an accommodation co-maker's or surety's rights are practically unaffected by the enactment of the Negotiable Instruments Law, as long as the instruments are in the hands of the payee, the same result must obtain when the note is held by any holder other than a payee who is unable to bring himself within the class of "holders in due course," because of failure to satisfy all the requirements enumerated in R. S. 1919, Sec. 838.[42] If, however, the suit upon the note is brought by an indorsee who holds in due course, a successful defense would be practically impossible, for in such case it seems that no other course would be before the Court but to adopt the reasoning stated above in connection with the discussion of *Lane v. Hyder,* and to hold the accommodation co-maker liable to such a plaintiff, even though the latter has destroyed some of defendant's subrogation rights. The opinion of Commissioner Railey in *Long v. Mason* was an exposition of the rights of an accommodation co-maker as against a holder in due course, but it was not concurred in by a majority of the Court. Of course, this line of argument was unnecessary to the decision of the Long case, since the Court there held the payee not to be a holder in due course. It is barely possible that if the Court were unable to decide the case for the defendant on the theory which was employed, they would look more favorably upon the theory expounded by Commissioner Railey. It was to the effect that the Negotiable Instruments Law makes no attempt to cut off the surety's equitable right of subrogation, and therefore the defendants may "set up their equitable counterclaim or cross action of subrogation, in bar of plaintiff's right of recovery." The opinion states:—

> The assertion of this right is not in conflict with any provision of the Negotiable Instruments Law, but on the contrary, proceeds upon the theory that respondents owe plaintiff the amount due on said note and have an equitable claim of subrogation against him, for the loss they have sustained by reason of the release to Helton of the 57 acres of land from said deed of trust, which should have been held for their benefit, as security for his indebtedness.

Only upon such theory as this could a surety defend a suit by a holder in due course. There are no decided cases in Missouri holding this defense to be a meritorious one; indeed, there is only one case in all th reports which gives support to this reasoning. The defendant in the case of *Scandinavian American Bank of Fargo v. Westby*[43] pleaded as counterclaim to a suit on promissory notes the plaintiff's destruction of defendant's subrogation rights. A majority of the Court ruled this to be a valid defense, drawing an interesting distinction between this cross-action for damages resulting from wrongful acts of plaintiff and an ordinary denial of liability upon the notes.

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[42] Uniform N. I. L. Sec. 52.
[43] 41 N. D. 276 (1918), 172 N. W. 665, l. c. 673.