The Doctrine of Swift v. Tyson and Bay v. Coddington

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SWIFT v. TYSON,
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BY

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1894.
CONTENTS.

I. INTRODUCTION.

II. THE DOCTRINE OF BAY v. CODDINGTON.

III. CASES FOLLOWING THE DOCTRINE OF THE ABOVE CASE.

IV. THE DOCTRINE OF SWIFT v. TYSON.

V. CASES FOLLOWING THAT DECISION.

VI. THE DIFFERENT ELEMENTS WHICH MUST EXIST.

VII. CONCLUSION.
INTRODUCTION.

While the leaning of the Federal Courts, has for a long time been inclined to the doctrine as laid down in Swift v. Tyson, there is a great diversity of opinion among the several States, and as equally eminent jurists have expressed their convictions on one or the other side of the question, and as, the number of States holding the doctrine of one class are about the same as the number holding the other way, we see that the question is nowise settled.

I shall endeavor to draw from a review of these decision that which seems to the writer the better doctrine to follow at the present time.
THE RIGHTS AND LIABILITIES OF A BONA FIDE HOLDER OF A NEGOTIABLE INSTRUMENT TAKEN AS COLLATERAL SECURITY FOR A PRE-EXISTING DEBT.

The first great case under which the above question arose is, the case of Bay v. Coddington, 5 Johns, Ch., 54,.

The question arose before Chancellor Kent, who held that one who received negotiable paper in the usual course of trade, for a fair and valuable consideration, was a holder for value, but that where such paper was deposited as collateral security against certain antecedent liabilities, the holder took the paper subject to the equities existing between the parties, (antecedent), to the note.

Upon the appeal taken, the court substantiated the law and doctrine as laid down in the former trial: and in an elaborate opinion of Woodwarth J. which we quote, the court laid down the principle more strongly. "The right to
hold against the owner in any case is an exception to the general rule of law: it is founded on principles of commercial law. The reason of such a rule would seem to be that the innocent holder, having incurred loss by giving credit to the paper, and having paid a fair equivalent, is entitled to protection. But what superior equity has the holder who made no advances, nor incurred any responsibility on the credit of the paper he received, whose situation will be improved, if he is allowed to retain, but, if not is in the condition he was before the paper was passed? To allow such a state of facts as sufficient to resist the title of the real owner would be productive of manifest injustice and it is enough if the holder be secure when he advances his funds, or makes himself liable on the credit of the paper he receives. In coincidence with this principle, it appears to me, all cases have been decided."

It might be well to state here the facts of this case, and do it as briefly as possible. One Bay, had a vessel to sell, he employed as agents Randolph and Savage to sell the same, which they did, selling her on credit. They
were authorized to sell her on credit if necessary, and transmit the notes to Bay. They took notes payable at the end of one, two, three, and four months. Some made payable to, and endorsed by P. Aymar & Co., and others by Q. R. Stewart. On the 12th. of June, 1819, R. and S. delivered the notes so indorsed to the defendants, J. & C. Coddington, who, were, at that time, as they stated in their answer under heavy responsibilities for R. & S. as indorsers of notes for their accommodation payable at different times, but all subsequent to the 12th. of June, 1819, and which they were afterwards obliged to take up as they fell due, amounting to above $17,000.

The answer admitted that R. & S. had stopped payment, when the notes so held by them were to be delivered to J. & C. Coddington. Defendants denied all knowledge of the manner in which the notes had come into the hands of R. & S. and alleged that they believed they were bona fide and exclusive property of R. & S.; that they received these notes with others as a guaranty and indemnity, as far as they would avail, for their responsibilities, and three days after disposed of some of the notes for cash. They admitted that
when they received the bills, R.& S. were not in a strict legal sense indebted to them. But they were under large gratuitous responsibilities to them.

Chancellor Kent, stated the opinion of the court as follows: "It is admitted that R.& S. held the notes belonging to the plaintiff, and which they transferred to the defendants, J.& C.Coddington, on the 12th. of June, 1819, as agents or trustees of the plaintiff, and that they had no authority to pass them away. It was a gross and fraudulent abuse of trust on the part of R.& S.,. The only question now is whether J. & C.C., are entitled to hold the notes, and retain the amount of them as against the plaintiff.

Negotiable paper can be assigned or transferred by an agent or factor or by any other person fraudulently, so as to bind the true owner as against the holder, provided it be taken in the usual course of trade, and for a fair and valuable consideration, without notice of fraud. But J.& C.C., do not come under that class. The notes were not so negotiated, nor for the payment of a pre-existing debt, nor for cash, or property advanced. They were received after R.& S.
had become insolvent. They are not holders for a valuable consideration within the meaning or policy of the law."

The next case that arose in N.Y., upon this point was that of Stalker v. McDonald, C Hill, 93, where the court laid down the following, though not in the language of the court shows the intent of the court at that date. The lower court had followed the doctrine of Bay v. Coddington, and an appeal being taken, solely for the purpose of having the court follow the decision of Swift v. Tyson, (which case had just been decided). The court holding that in questions of local law, it was the duty of the courts to follow the precedents of state decisions, not those of Federal Courts. And in an elaborate review of the cases before decided upon this question, the court with some little hesitancy, decided to follow the doctrine as laid down in Coddington v. Bay.

The court holding as follows: Paper taken as collateral security for an antecedent debt---- "One who takes a note merely as collateral security for an antecedent debt, without advancing anything upon it or relinquishing any security, is not a holder in the due course of trade."
The cases which have arisen in New York since the two cases of Bay v. Coddington, and Stalker v. McDonald, have been merely a repetition of those decisions, and the courts seem to be bound to follow the rulings of those cases whether the facts are similar or not..

But in the case of Brown v. Leavitt, 31 N.Y., 113, the court held, that where a note is taken in payment of an over-due note, the person becomes a holder for value. And the court refused to open discussion on the question, saying, "A further discussion of the question might lead to a suspicion that the law was not settled and in doubt upon this point."

But there is a clear distinction between this case and the case of Bay v. Coddington. In that case the notes were taken as security of and for notes that were not yet due, and from persons who had not the authority to so transfer them, but in the present case, the notes were taken for debts that were already and over-due. Thus this case does not over-rule the case at bar.

The next case at bar, was that of Bank of the State of
New York v. Vanderhorst, 32 N.Y., 522. The decision of this case was adverse to the decision of Bay v. Coddington, but the reasons were plainly clear, in the present case the notes were taken by a bona fide holder for value without notice of any equities, and in the usual course of trade and business, but in the previous case of Bay v. Coddington, the notes were not taken free from any equities, as the court almost as much as said that there were elements of fraud and collusion existing, and that they were not taken in the usual course of trade and business.

And what constitutes a bona fide holder seems to bear greatly upon the reasons for the difference of these two decisions. Whether a person who receives a promissory note, which has been diverted from the purpose for which it was made, be a bona fide holder, depends upon the fact of his having parted with value, at the time. If he merely take it as collateral security for a pre-existing debt, he is not a holder for value, and is not entitled to recover as a bona fide holder for value.

The next case in New York, was that of Brookman v Metcalf.
32 N.Y., 504, where the court substantiated the doctrine of Bank v. Vanderhorst, holding, that where an insurance company takes notes as payment for advance premiums and hold not the same as security merely, they are bona fide holders for value and are entitled to such protection. And have the right to transfer the same in payment of a debt, and the party taken the same is a bona fide holder without equities.

The reasons for the court diverting from the decision of Bay v. Coddington, are the same as laid down in the case before.

In the case of Pratt v. Coman, 37 N.Y., 513, a case which is sometimes cited as overruling the case of Bay v. Coddington, is in fact a case that has nothing similar whatever to the case just mentioned. Here the holder of a note transfers his own note, which note of his given is ever due, and receives in exchange a note of a third person, before its maturity, is held to be a bona fide holder for value.

But now if it had distinctly appeared in the above case that the note was to be held simply as a security for the debt due to the plaintiff for the money loaned, the plaintiff
having the right and privilege to sue for the debt at any moment he saw fit, than I think this case would fall under the head of Bay v. Coddington, and with the present ruling would then overrule that decision, but as it stands I think it has no bearing upon the case whatever.

Before tracing further the cases laid down in New York, which are in opposition, let us look at the decisions of other States that have followed the doctrine of this famous case.

By a careful review of the decisions of the different states, I have found that the following States have supported the doctrine of the early New York courts, viz:—Maine, New Hampshire, Pennsylvania, Arkansas, Wisconsin, Ohio, Kentucky, Tennessee, Iowa, Alabama, North Carolina, and Virginia.

Although there have been rulings in several of these States to the contra, yet I feel safe in saying that these States stand by the doctrine of the New York court in the case of Bay v. Coddington.

These States substantially holding the following: that a bona fide holder of a note taken as collateral security for
antecedent or pre-existing liability, is considered to take it subject to the equities existing between the prior parties to the bill.

In Maine, the question arose in the case of Bramegall v. Beckett, 31 Me., 205. The court in the opinion said that the case had never been passed upon before in that State; but they held, "on general principles as well as upon authority, that the indorsee of an accommodation bill or note, who has given no consideration for it, and who does not claim through a party for value, is not entitled to protection against the equities of the accommodation maker. If he received a bill or note as collateral security merely, for a pre-existing debt without notice, parting with no right whatever, or extending any forbearance, or giving any other consideration, the transaction will not constitute a commercial negotiation in the usual course of business and trade, and he cannot be regarded as a holder for a valuable consideration."

This decision seems to me to be in line with that of Bay v. Coddington, and the reasons for the court so deciding
is one of no question for dispute whatever, for the facts are such as seems to me to be the only just decision that could be reached under such reasoning.

In the case of Petrie v. Clark, 11 S. & R., 377 (Pa.), the court followed the above rule in quite an able decision. The facts were as follows: Here A. being indebted to B. on his own note, after it became due arranged with B. to have it taken up by him, and to have a new note of five months substituted for it, and gave B. another note of one C's. to be kept by him as collateral security for the debt. Judge Gibson who rendered the decision of the court, laid down in substance the following: That there is a great difference between the pawning of a security for a past debt, than of the pawning for a present debt, or for money advanced at the time. As to the first, all the cases agree, that the interest of the pawnee is defeasible by creditors or legatees.

As to the latter is where the dividing line presents itself, but the court adopted the rule of New York, although not doing so in express terms.

In Royer v. Bank, 4 W.N.C., 16, (Pa.). The court reiter-
ated the same doctrine, and went still further, in holding that a valuable consideration was not to be implied from the mere renewal of a negotiable paper, and the same defence can be made to the note given in renewal as to the original note.

In Lee v. Smead, 1 Met., 628, (Ky.) The question arose and the court followed the N.Y. rule. Duval. J., cited at length from the opinion of Woodwarth. J., and in his opinion decided that the question was a local one, and should be governed by State decisions, and not by U.S. courts.

In Reddick v. Jones, 6 Ired., 107, (N.C.), the court in delivering the opinion, was somewhat doubtful as to which was the better law, but intimated that the holder of a note as collator, was not a bona fide holder for value.

Tennessee, also in several early decisions was somewhat in doubt as to which of the line was the better to follow, but in the case of King v. Doolittle, 10 Yerg., 77, came out square and declared that the law was settled in Tennessee, and the same was in accordance with the principles of the New York decision of Bay v. Coddington.

In Iowa the courts decided to follow the doctrine as
laid down in the Ohio courts.

The law in Ohio upon this question has been at variance: in an early decision, they attempted to follow the doctrine as laid down in the U.S. courts, 11 Ohio, 172, but in a case in 6 Ohio St., 448, Roxborough v. Nesick, they returned to the doctrine of the New York courts. In this latter case the court laid down the principle as follows: "When a note of a third person is transferred bona fide before due, as a collateral security and for value, such as a loan or further advancement, or stipulation, express or implied, of further time to pay a pre-existing debt, or a further credit, or a change of security of a pre-existing debt, or the like, the assignee of such collateral will be protected from infirmities affecting the instrument before it was thus transferred. If however, a note is transferred as collateral security to a pre-existing debt, without any consideration, so that the transfer is a mere voluntary act on the part of the debtor, and is received by the creditor without incurring any new responsibility, parting with any right, or subjecting himself to any loss or delay, and leaving the subsisting debt precise-
ly in the condition it was before such collateral was taken, the holder has not taken the note for value, nor in the usual course of trade; and to hold otherwise, would be a departure from the established rules of law governing the rights of parties to negotiable paper, and losing sight of the grounds of public policy upon which the law is founded."

Here in this case a debt was contracted, nothing was entered into for any further security of the debt, and the debtor afterward, without necessity for doing so, or any obligation for the same, transfers a negotiable instrument, to secure a pre-existing debt, the parties being in the same relation there is no new consideration between the parties, and as the note in the present case was not taken in the usual course of trade, I think the court was right in holding that he was bound to take it subject to all equities existing between the antecedent parties, at the time the transfer was made.

In the case of Carlisle v. Wishart, 11 Ohio, 172, Judge Wood, stated the question as to what the court was to base their decision on was as follows: "This motion, it will be
seen therefore presents the question for the consideration of the court, whether the transfer for a negotiable note, before due, and without notice, and the consideration of the transfer of a precedent debt, subjects the indorsee to all the equities existing between the original parties."

This case was decided in the lower court merely on the grounds of it having been transferred for a pre-existing debt the court seeming to think that of itself was enough to defeat the plaintiff's action to recover. But in the higher court it was reversed solely on the weight of the dicta in the case of Swift v. Tyson.

I could cite cases indefinitely almost upon this side of the question but I have another line of cases to consider, those following the doctrine of Swift v. Tyson, the substance of which doctrine can be briefly stated as follows: A person who is the bona fide holder of a bill of exchange or a note, and who takes before maturity, in payment of a pre-existing debt without notice of any equities existing between the drawer and acceptor, is unaffected by those equities.
The first case that naturally follows for us to consider is the case which is the root of all the decisions which have since arisen:— The case of Swift v. Tyson, 16 Peters, 1.

The facts of this case are substantially as follows:

An action was brought by the plaintiff S. as indorsee, against the defendant, T. as acceptor upon a bill of exchange made at Portland, Maine, May 1, 1836, for the sum of $1540.30 payable six months after date and grace drawn by one Norton, and one Keith, at the city of New York, in favor of the order of Norton, and by Norton indorsed to the plaintiff. The bill was dishonored at maturity, at the trial the acceptance and indorsement of the bill were admitted, and the plaintiff there rested his case. The defendant then introduced evidence which was Swift's answer to a bill of discovery, by which it appeared that Swift took the bill before it became due, in payment of a promissory note due to him by Norton and Keith; that he understood that the bill was accepted in part payment of some lands sold by Norton to a company in New York.

Judge Story in delivering the opinion of the court said:—

"We have no hesitancy in saying that a pre-existing debt
does constitute, a valuable consideration in the sense of
the general rule already stated, as applicable to negotiable
instruments. Assuming it to be true (which, however,
may well admit of some doubt from the generality of the lan-
guage) that the holder of a negotiable instrument is unaf-
fected with the equities between the antecedent parties, of
which he has no notice, only where he receives it in the
usual course of trade and business for a valuable considera-
tion, before it becomes due, we are prepared to say, that
receiving it in payment of or as security for a pre-existing
debt is according to the known and usual course of trade and
business. And, why, upon principle, should not a pre-exist-
ing debt be deemed such a valuable consideration? It is for
the benefit and convenience of the commercial world to give
as wide an extent as practicable to the credit and circula-
tion of negotiable paper, that it may pass not only as se-
curity for new purchases and advances made upon the transfer
thereof, but also in payment of and as security for pre-
existing debts. The creditor is thereby enabled to realize
or secure his debt, and thus may safely give a prolonged
credit, or forbear from taking any legal steps to enforce his rights. The debtor also has the advantage of making his negotiable security of equivalent value to cash."

I shall next endeavor to cite a few cases scattered throughout the different states of the union which follow the doctrine as just enunciated.

We find that the number of states that follow the doctrine of Swift v. Tyson, are just as numerous if not more so than those which follow the doctrine as laid down in Bay v. Coddington.

The following states have supported the doctrine of Swift v. Tyson: Massachusetts, Rhode Island, Connecticut, Vermont, New Jersey, Illinois, Indiana, Missouri, California, Texas, Georgia, Mississippi, South Carolina, and also England has supported this later decision as the better law.

In the case of Blanchard v. Stevens, 3 Cush., 162, the question did not squarely arise before the court, but in the course of the opinion delivered by Judge Dewey, he in his dicta, laid down that which would be the law assuming the facts of the Swift v. Tyson case, assuming that a note was
taken as collateral security, instead as a payment of a debt, the equities of the former party would be excluded. He held that if the parties had not received the notes as collateral security, they might have pursued other remedies to enforce the security of the payment of the debt. "It is fallacy to say that if the plaintiffs are defeated in their attempts to enforce the payment of these notes by allowing this defence to prevail, yet nevertheless they are in as good a situation as they would have been if the notes had not been transferred to them. The convenience and safety of those dealings in negotiable paper seem to require and justify the rule."

Nearly all the decisions that have been decided upon this point in the line of and with the doctrine of Swift v. Tyson, have based their grounds of decision upon the question as to whether the notes were taken in the usual course of trade and business, and if so taken they were not subject to the equities of the antecedent parties they being bona fide holders, and therefore were not subject to the equities .

Such was the reasoning of the Rhode Island courts in
the two cases of Bank v. Carrington et al., 5 R.I., 515; and Cobb v. Doyle, 7 R.I., 550. In the former the court held that the papers were taken in the usual course and business of trade, and as commercial papers should be given all the credit and currency possible, therefore it should be the duty of the court to encourage not discourage the transfer of negotiable instruments. And in the latter case the court reasoned in the same line holding that it was the duty of courts to look after the interests of commercial paper with as much wisdom as possible.

Again many of the courts have gone a step further in advance, and opened up a wider field for the circulation of negotiable instruments, by holding that there was no difference between the giving of a note as payment of a debt, of the giving of the same as a security for an antecedent debt. Both constituting the holder a holder for value. Osgood v. Bank, 30 Conn., 217; Roberts v. Hall., 213; Bridgeport v. Welch, 29 Conn., 475;

A question which was raised in the case of Swift v. Tyson, was, whether the question as to the negotiability of
papers, whether the same came under the head of negotiable papers, or under the Federal courts, and were to be governed by the same. But the court in this case held that the section of the Judiciary act referred to, governed the title of real property not questions of general commercial law such as bills of exchange or promissory notes. And they held that the stress placed upon the word "laws" in the statute referred to merely local laws generally and not to laws and questions affecting the general commercial world.

In the case of Phoenix Ins. Co. v. Church, 81 NY., 218, (which is about the latest case of any importance that has been decided in New York) the court followed the doctrine of Bay v. Coddington, on the very same grounds as in that case. In this case a note was transferred in fraud of one of the antecedent parties, and the court without any hesitancy laid down the rule as follows:— "Prior equities of antecedent parties to negotiable paper transferred in fraud of their rights will prevail against an indorsee who has received it merely in nominal payment of a precedent debt."
Thus we now reach a point in our discussion where it becomes necessary for us to define:

First. What constitutes a person a holder for value.

It will be perceived that the ground upon which the holder of a negotiable paper, taken in payment of a precedent debt, is held to be a holder for value, is, that he receives the paper as a payment of the original debt, whereby the original debt is at least for the time being, discharged. The creditor is in effect a purchaser of the negotiable paper; and for it he parts with the original obligation of the precedent debt, changing thereby his relations to his debtor and the liability of the debtor to him. And it is this leading fact in these line of cases that should be distinguished and brought to our sight, as in my mind it this method of regulation of the pre-existing indebtedness that makes the creditor a holder for value.

Second. What constitutes " in the usual course of trade and business".

In order that a bona fide holder may claim protection against defences, not appearing on the face of commercial
paper, it is said that he must have acquired it in the "usual course of business". This phrase means according to the usages and customs of commercial transactions.

Third. What will constitute a valuable consideration.

Will a pro-existing debt constitute a sufficient consideration? From the weight of text-writers, it seems to me that it would be sufficient, as it has been generally held that an existing debt is sufficient consideration for a note or other commercial instrument. This is true, whether the existing debt is an open account or one of some other nature, there seemsto be sufficient consideration to support them.

Wherein therefore does the distinction between these two doctrines lie. It seems to me from the facts of the case of Bay v. Coddington, that the transaction was not made in the _usual course of trade and business_, and it is plainly to be discerned from the decision of the court that there were elements of fraud running through the whole transaction, thus not making the party a bona fide holder for value. And I think the court in this case done that which was just and equitable in the rendering of their decision. But look at
facts in the case of Swift v. Tyson, here everything was done in the usual course of business, and there was not the least element of fraud to be seen from the transaction, and I think the court that rendered the decision in the case of Bay v. Coddington, with these same facts before them would have reached the same decision as did the Federal Court.

But the trouble does not stop here. Later courts without even weighing or looking at the reasoning of the decision in that case go on in blind error and follow that decision as though duty bound to do it, without regard to justice or equity.

Taking the weight of authority into consideration, and the reasons on which they rest, I think the courts of the different states should not hesitate to follow the rule laid down by the Supreme Court of this Country. In doing this no one is injured, for it is only enforcing a good rule, that has, in some instances, been departed from; it is not adopting any rule which is to change any rights of property; and if it has a tendency to prevent one from parting with his name in a negotiable form, it might in that respect operate beneficially.
If we follow the rule as laid down in Bay v. Coddington, where will we come to in regard to negotiable papers. If the holder of a negotiable bill or note can be met with the same defense, that could be made to the original payee, from whom he received it, what becomes of all classes of bills and notes made for the accommodation of some of the parties? None of the original parties to such paper could maintain any action on it.

We are living in an age of business and hustle where business requires all the assistance that it can receive to keep it on its feet; and the freedom of exchange is one that is necessary in a busy world; then why place a monument upon it, why not increase, then endeavor to decrease the right of circulation, that what is being done every time the court follows the decision of Bay v. Coddington, they are opening a field of doubt, and if continued it will only be a question of short time when the privilege of negotiability will be relegated to the past.
CONCLUSION.

We find therefore, by a careful review of the different cases that have arisen throughout the State and United States Courts, there is no settled doctrine for future courts to follow. And as the decision and precedents of the rulings of the Federal Courts are not bound to be followed, the State courts are open to any line that they may choose.

But it seems to me that the better rule would be, the one, that puts as little restraint on negotiability as possible, and allows a wide field of circulation of commercial paper.

Fred Brownell Davis, '94.
May, 21, 1894.