



3-1-1959

Conflict of Laws: Uniform Commercial Code -- Commercial Paper Transactions Between Code and Non-Code States: A Problem with Applicable Law

John F. Beggan

Alfred A. Kaelin

Follow this and additional works at: <http://scholarship.law.nd.edu/ndlr>



Part of the [Law Commons](#)

Recommended Citation

John F. Beggan & Alfred A. Kaelin, *Conflict of Laws: Uniform Commercial Code -- Commercial Paper Transactions Between Code and Non-Code States: A Problem with Applicable Law*, 34 Notre Dame L. Rev. 209 (1959).

Available at: <http://scholarship.law.nd.edu/ndlr/vol34/iss2/4>

NOTES

Conflict of Laws

UNIFORM COMMERCIAL CODE—COMMERCIAL PAPER TRANSACTIONS BETWEEN CODE AND NON-CODE STATES: A PROBLEM OF APPLICABLE LAW

Introduction

With the development of rapid communications and mass transportation came the multi-state commercial transactions and the consequent Uniform Negotiable Instruments Law, which was drafted to insure the free circulation of negotiable paper. Since it was eventually adopted by all states, few conflict of laws problems developed in the area of commercial paper. In an attempt to further simplify, modernize, and permit the continued expansion of commercial transactions and the law governing them, the Uniform Commercial Code was prepared for the consideration of various state legislatures. At the present time it has been enacted in three states,¹ and it is expected that other states will follow this lead.² However, until there is a truly uniform law, conflict of laws problems will arise, since the Code differs from the NIL in some respects. Recognizing this, the formulators of the Code inserted a section which was intended to be determinative of which state's law should be applied to any particular transaction.³ This section, as originally presented, was the subject of some criticism⁴ and was adopted only by Pennsylvania. It has since been revised, and in this form it has been adopted by Massachusetts and Kentucky.

It is not the purpose of this Note to indicate all of the innovations which the Code makes in respect to commercial paper. Rather, a few of the areas in which conflicts problems may arise will be examined in light of the principles which the courts are likely to use in resolving them. In order to do this, the problem resulting from a difference of interpretation under the NIL as to whether a payee may be a holder in due course will be formulated. Then, the conflict of laws rules which have been utilized in the past will be discussed as they apply to this problem. Finally, the conflicts provision of the Code will be compared with common law principles in connection with this problem and other differences between the substantive provisions of the NIL and the Code to determine whether, in event the Code is applied, a different result would obtain.

I. THE PAYEE AS A HOLDER IN DUE COURSE

In order to protect the holder in due course from the personal defenses available against former owners of a negotiable instrument, the NIL declares that he ". . . holds the instrument free from any defect of title of prior parties, and free from defenses available to prior parties among themselves. . . ."⁵

¹ Pennsylvania, PA. STAT. ANN. tit. 12A, §§ 1-101 — 10-104 (1954); Massachusetts, MASS. ANN. LAWS c. 106, §§ 1-101 — 9-507 (Supp. 1958); Kentucky, KY. REV. STAT. ANN. §§ 1-101 — 10-104 (Supp. 1958).

² It has been reported that the 1957 edition of the Code will be introduced into the legislatures of approximately fourteen states in 1959. These states include Connecticut, Maine, New Hampshire, Vermont, Ohio, Indiana, Michigan, Illinois, North Dakota, Colorado, Nevada, New Mexico, Utah, and possibly Wyoming. Levy, *Current Developments on the Uniform Commercial Code*, 63 COM. L.J. 322 (1958).

³ UNIFORM COMMERCIAL CODE § 1-105. All references are to the 1957 edition of the Code unless otherwise indicated.

⁴ See *Panel Discussion on the Uniform Commercial Code*, Bus. Law., Nov. 1956, p. 49, 68-75; Smith, *Conflicts and Chaos or Contract and Uniformity: The Uniform Commercial Code*, 2 KAN. L. REV. 11 (1953). But see Goodrich, *Conflicts Niceties and Commercial Necessities*, 1952 WIS. L. REV. 199.

⁵ UNIFORM NEGOTIABLE INSTRUMENTS LAW § 57.

It was well-settled at common law that a payee who took a negotiable instrument for value and without notice of any defect was a holder in due course despite any personal defenses the maker might have.⁶ Thus, where a maker fraudulently obtained the signature of an accommodation maker or a co-maker and then transferred the paper to an innocent payee for value, the co-maker could not plead fraud in an action on the paper by the payee.⁷

A quirk of statutory interpretation by some American courts after the enactment of the NIL has resulted in some states taking the position that a payee cannot be a holder in due course.⁸ This results from a narrow interpretation of sections 191, 52, and 30 of the NIL. A payee can obviously be a "holder" under section 191 which defines a "holder" as "the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof." But section 52(4) requires as a condition of one's being a holder in due course, "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." This is taken to mean that there is a positive requirement that the instrument must have been "negotiated" and the divergence of opinion arises in determining whether a payee takes by "negotiation." In deciding this, all courts turn to section 30, which defines negotiation as follows: "An instrument is negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the holder thereof." If the negotiable paper were transferred to a payee, he would seem to satisfy this definition, but the section adds: "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." This latter sentence of section 30 presumes negotiation by a "holder" of an instrument already issued since it requires an indorsement of order paper, and the maker or drawer obviously does not indorse the instrument he initiates.⁹ Despite this problem of interpretation, it is generally held that a transfer to a payee is a "negotiation"¹⁰ and that a payee may be a holder in due course if he meets the conditions of section 52 of the NIL.¹¹ *Vander Ploeg v. Van Zuuk*¹² appears to be largely responsible for the minority view that a payee cannot be a holder in due course.

⁶ *Armstrong v. American Exch. Nat'l Bank*, 133 U.S. 433 (1890); *Lucas v. Owens*, 113 Ind. 521, 16 N.E. 196 (1888); *Watson v. Russell*, 3 B. & S. 34, 122 Eng. Rep. 14 (Q.B. 1862), aff'd, 5 B. & S. 968, 122 Eng. Rep. 1090 (Ex. 1864); *Poirer v. Morris*, 2 El. & Bl. 89, 118 Eng. Rep. 702 (Q.B. 1853); *Munroe v. Bordier*, 8 C.B. 862, 137 Eng. Rep. 747 (C.P. 1849). For a discussion of the historical development of the problem see *Aigler, Payees as Holders in Due Course*, 36 *YALE L.J.* 608 (1927).

⁷ *Anderson v. Warne*, 71 Ill. 20; 22 Am. Rep. 83 (1873); cf. *Tischhauser v. Prentice*, 30 Cal. App. 699, 159 Pac. 226 (1916).

⁸ For a summary of the positions of the various states and a collection of authorities on the subject, see *BEUTEL, BRANNAN'S NEGOTIABLE INSTRUMENTS LAW* 674-91 (7th ed. 1948).

⁹ This reasoning is discussed and followed in *Davis v. National City Bank*, 46 Ga. App. 194, 167 S.E. 191 (1932).

¹⁰ *Drumm Constr. Co. v. Forbes*, 305 Ill. 303, 137 N.E. 225 (1922); *Liberty Trust Co. v. Tilton*, 217 Mass. 462, 105 N.E. 605 (1914).

¹¹ *Snyder v. McEwen*, 148 Tenn. 423, 256 S.W. 434 (1923); *Ex parte Goldberg & Lewis*, 191 Ala. 356, 67 So. 839 (1914), gives a full discussion of the early English, Canadian, and American cases. *BEUTEL, op. cit. supra* note 8, at 674-91 summarizes the positions of the various states.

¹² 135 Iowa 350, 112 N.W. 807 (1907). This case followed *Herdman v. Wheeler*, [1902] 1 K.B. 361, which held that a payee could not be a holder in due course under the Bills of Exchange Act, 1882, 45 & 46 Vict. c. 61 from which the sections of the NIL in point were taken. But in *Lloyd's Bank, Ltd. v. Cooke*, [1907] 1 K.B. 794, a contrary result was reached on the grounds of estoppel. *Herdman v. Wheeler* was considered and distinguished. In a concurring opinion of the Lloyd's Bank case, [1907] 1 K.B. 794, 808, it was reasoned that a payee may take by negotiation and therefore be a holder in due course. The argument advanced was that according to the act, "a bill is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder of the bill," and that if the word "holder" were replaced by its definition in the act: "the payee or indorsee who is in possession of the bill," it would be clear that the issuance of a bill to a payee would be a "negotiation" within the meaning of the act. This same type of reasoning is used and enlarged in *BEUTEL, op. cit. supra* note 8, at 675-76.

Since negotiable paper is often delivered to an intermediary conditionally or for a particular purpose, the additional question arises as to whether the payee takes subject to the conditional limitation. Section 16 of the NIL provides: "As between immediate parties . . . the delivery . . . may be shown to have been conditional or for a special purpose only. . . . But where the instrument is in the hands of a holder in due course, a valid delivery thereof . . . is conclusively presumed." The argument that a payee is an "immediate" party within the meaning of this section is rejected in those jurisdictions where a payee is regarded as a holder in due course under sections 191, 52, and 30.¹³

It is not necessary for the purposes of this Note to consider the merits of these arguments.¹⁴ It is sufficient to note that a split of authority exists. In contradistinction, the Code leaves no room for such a basic difference of interpretation, for it expressly adopts the position that a payee may be a holder in due course to the same extent and under the same circumstances as any other holder, whether he takes the instrument by purchase from a third person or directly from the obligor.¹⁵ Thus, the Code adopts the majority rule concerning the status of a bona fide payee for value, and although there was a possible area in which a conflict of laws situation could arise by virtue of diverse interpretations of the NIL, the conflict is likely to become more intensified as more states adopt the Code.

In determining the question of which state's law will govern the payee's position, courts operating within the scope of the NIL have a variety of general legal principles available as aids in resolving this problem wrought by a difference in statutory interpretation. Since the NIL makes no provision for conflict of laws problems, general contract principles as to what law governs are applicable.¹⁶ These tests will be examined and applied to the problem of M, the maker, who fraudulently induces CM to sign a note as co-maker in a state following the minority rule that a payee cannot be a holder in due course, and who then mails it to P, the payee, who takes it in good faith for value, and who resides in a state which follows the majority rule. P then institutes suit against the co-maker to recover on the note.

II. CONFLICT OF LAWS PRINCIPLES AND THEIR APPLICATION AT COMMON LAW

A. Place of Contracting

In the contract field it is frequently necessary to determine where the contract was made, since the solution of many conflict problems depends upon the place of contracting. The forum determines this place in accordance with its own conflict of laws rules.¹⁷ It is generally said to be the state in which the last act necessary to make a binding contract takes place.¹⁸ Where a negotiable instrument is involved, the decisive question is the determination of the place where it was executed and delivered, because the NIL requires delivery of such an instrument for it to be effective.¹⁹ The place of delivery may be other than the place of signing.²⁰ For example, when a bill or note is drawn and signed in one jurisdiction and mailed from there to the payee in another jurisdiction at the request of the payee, it is deemed to be executed at the place of

¹³ *Liberty Trust Co. v. Tilton*, 217 Mass. 462, 105 N.E. 605 (1914).

¹⁴ There has been a wealth of material written on this problem. Most authorities agree that the better view is that a payee may be holder in due course, although no categorical answer is possible without considering the particular facts. See generally, Aigler, *supra* note 6; Britton, *The Payee as a Holder in Due Course*, 1 U. CHI. L. REV. 728 (1934).

¹⁵ UNIFORM COMMERCIAL CODE § 3-302(2) and comments thereto.

¹⁶ *John Hancock Mut. Life Ins. Co. v. Fidelity-Baltimore Nat'l Bank & Trust Co.*, 212 Md. 506, 129 A.2d 815 (1957); *Houston v. Keith*, 100 Miss. 83, 56 So. 336 (1911); *Garrigue v. Keller*, 164 Ind. 676, 74 N.E. 523 (1905).

¹⁷ *Illinois Fuel Co. v. Mobile & Ohio R.R.*, 319 Mo. 899, 8 S.W.2d 834, *cert. denied*, 278 U.S. 640 (1928); RESTATEMENT, CONFLICT OF LAWS § 311 (1934).

¹⁸ *Knights of Pythias v. Meyer*, 198 U.S. 508 (1905); *Smith v. Onyx Oil & Chem. Co.*, 218 F.2d 104 (3d Cir. 1955); *Aruthur A. Bishop & Co. v. Thompson*, 99 Vt. 17, 130 Atl. 701 (1925).

¹⁹ UNIFORM NEGOTIABLE INSTRUMENTS LAW § 16.

²⁰ *Tilden v. Blair*, 88 U.S. (21 Wall.) 241 (1874); *Kiess v. Baldwin*, 74 F.2d 470 (D.C. Cir. 1934).

mailing if the delivery to the post office completes the contract between the maker and the payee.²¹ The payee's request to use the mail may be implied,²² but if there is no such request expressed or implied, the instrument is not delivered until received.²³ If the note were signed in one state and physically delivered to the payee in another state, the contract is considered to have been made in the latter jurisdiction.²⁴

It is generally stated that the nature, validity, obligation, legal incidents, construction, interpretation, and contractual rights are governed by the law of the place of contracting.²⁵ The question of whether a person is a holder in due course involves contractual rights and obligations and does not relate merely to the remedy. Therefore, the rights of the parties to a bill or note and the incidents of the consequent obligation are often said to be governed by the law of the place where it was executed and delivered.²⁶

Under this conflicts test the payee's position, in the example given, will depend on where the contract was completed by delivery. If it was "made" where it was mailed, the payee will not be considered a holder in due course. But if there were no request, expressed or implied, to use the mail by the payee, the contract would be considered "made" where it was received, and the payee could be a holder in due course, since it is assumed that the latter jurisdiction follows the majority rule.

B. Place of Performance

If the instrument states a place of performance which differs from the place of making, the problem becomes more involved. It is presumed that the parties contracted in reference to the place of payment, and many courts will say that the *lex loci solutionis* governs without considering where the instrument was made, signed, dated or delivered.²⁷ This is done in order to give effect to the presumed intention of the parties.²⁸ The rationale appears to be that the statement of where performance is to take place is a clearer indication of the parties' intent as to what law shall govern than the place of contracting. However, it is sometimes stated that the law of the place of performance

²¹ *Burr v. Beckler*, 264 Ill. 230, 106 N.E. 206 (1914); *Barrett v. Dodge*, 16 R.I. 740, 19 Atl. 530 (1890).

²² *In re Lucas' Estate*, 272 Mich. 1, 261 N.W. 117 (1935).

²³ *Freeland v. Carmouche*, 177 La. 395, 148 So. 658 (1933). If the efficacy of the instrument is contingent upon its acceptance by the payee, it is executed where it is received and accepted. *Navajo County Bank v. Doslon*, 163 Cal. 485, 126 Pac. 153 (1912). In the case of a renewal note, the delivery to the payee is conditional until the original note is given back to the maker. Therefore, the place of making a renewal note is where the payee receives it and returns or mails the original note to the maker. *Staples v. Nott*, 128 N.Y. 403, 28 N.E. 515 (1891); *Bell v. Packard*, 69 Me. 105, 31 Am. Rep. 251 (1879); *RESTATEMENT, CONFLICT OF LAWS* § 313 (1934). *Contra*, *Douglas County State Bank v. Sutherland*, 52 N.D. 617, 204 N.W. 683 (1925).

²⁴ *Kiess v. Baldwin*, 74 F.2d 470 (D.C. Cir. 1934); *Thompson v. Taylor*, 66 N.J.L. 253, 49 Atl. 544 (1901).

²⁵ *Keehn v. Rogers*, 311 Mich. 416, 18 N.W.2d 877 (1945); *Owens v. Hagenbeck-Wallace Shows Co.*, 58 R.I. 162, 192 Atl. 158 (1937); *Lams v. F.H. Smith Co.*, 36 Del. 477, 178 Atl. 651 (1935); *RESTATEMENT, CONFLICT OF LAWS* § 332 (1934). On the question of where the contract was entered into, the intention of the parties prevails. It may be found in the nature of the transaction, the subject matter of the contract, or surrounding facts and circumstances. *Philip Carey Co. v. Maryland Cas. Co.*, 201 Iowa 1063, 206 N.W. 808 (1926). See also, 2 BEALE, *CONFLICT OF LAWS* 1171-74 (1935).

²⁶ *Coral Gables, Inc. v. Christopher*, 108 Vt. 414, 189 Atl. 147 (1937); *Ellis v. Crowe*, 193 Ark. 255, 99 S.W.2d 568 (1936); *Alropa Corp. v. King's Estate*, 279 Mich. 418, 272 N.W. 728 (1937). Goodrich states that this method of determining the legal consequences of an act by the rules of law in force where it is done is the natural way of settling problems under the common law. He also points out that this test has the practical advantage of certainty, a desirable attribute especially in commercial matters, which allows a lawyer to advise a client with reference to the law which will be used if the contract is involved in litigation, and, more important, it allows him to assist in drawing up agreements which will not become involved in litigation. *GOODRICH, CONFLICT OF LAWS* 322 (3d ed. 1949).

²⁷ *Sterret v. Stoddard Lumber Co.*, 150 Ore. 491, 46 P.2d 1023 (1935); *Commercial Credit Corp. v. Boyko*, 103 N.J.L. 620, 137 Atl. 534 (1927); *Walling v. Cushman*, 28 Mass. 62, 130 N.E. 175 (1921); *Pratt v. Dittmer*, 51 Cal. App. 512, 197 Pac. 365 (1921).

²⁸ *Hall v. Cordell*, 142 U.S. 116 (1891); *Reighley v. Continental Illinois Nat'l Bank & Trust Co.*, 390 Ill. 242, 61 N.E.2d 29 (1945); *Edgington v. Edgington*, 179 Tenn. 83, 162 S.W.2d 1082 (1942).

should be applied only to matters relating to performance.²⁹ If no place of performance is stated, it is presumed that the parties contemplated the law of the place where the instrument was made.³⁰

Thus, if the note in the example being used states that it is to be paid at the place of business of P, the payee, which is in a state following the majority rule, he could be a holder in due course. If no place of performance were mentioned, the place-of-contracting rule discussed above would be used.

C. Intention of the Parties

A third theory which has been used in the task of selecting what law is to apply holds that the law which the parties intended or may fairly be presumed to have intended shall govern.³¹ Thus, if it is clear that the parties intended the contract to be governed by the law of the place where it was made or some other place, or if the parties stipulate in good faith that the law of another state shall govern, such law is determinative, and the *lex loci solutionis* does not apply.³² In the absence of an express stipulation that the law of a particular jurisdiction is to govern, the tests of place of contracting and place of performance are often used by the courts as indicative of the intention of the parties. That is, the circumstances surrounding the transaction are examined, and, in the absence of factors indicating a different intent, the courts presume that the law of the place of contracting or of the place of performance, if stated, is the law with a view to which the contract was made.³³ Of course, the intermingling of these tests leads to some confusion and to difficulties in reconciling the decisions. As Goodrich points out:

Frequently it will be said that the law of the place of performance is presumably that intended by the parties, so it is sometimes hard to tell whether a court is applying the law of the place of performance because this law is supposed to be the one which governs or because the parties are supposed to have intended it.³⁴

The intention rule has been the subject of criticism,³⁵ and the Restatement favors the place-of-contracting theory except for matters relating to performance.³⁶ Some

²⁹ *Seudder v. Union Nat'l Bank*, 91 U.S. 406 (1875); *In re American Fuel & Power Co.*, 151 F.2d 470 (6th Cir. 1945), *aff'd sub nom. Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156 (1946); RESTATEMENT, CONFLICT OF LAWS §§ 332, comment c, and 358 (1934). Goodrich suggests that referring the validity of a contract to the place of performance involves looking to some law other than the place where the acts are done to determine their legal effect, and that the logical analogies support the place of making rather than the place of performance. While admitting that the place-of-performance rule could be adopted for considerations of commercial convenience or others, he believes that no such considerations are apparent. *Bernstein v. Lipper Mfg. Co.*, 307 Pa. 36, 160 Atl. 770 (1932) uses Goodrich's reasoning that the weakness of the place-of-performance rule is shown when performance is to take place in more than one state. In such a case, "there seems nothing left but to apply the local contract rules of the *lex loci contractus*, unless the question of validity is to be chopped up into as many pieces as there are different places for performance." GOODRICH, *op. cit. supra* note 26, at 325.

³⁰ *Folsom v. Continental Adjustment Corp.*, 48 Ga. App. 435, 172 S.E. 833 (1934).

³¹ *Shotwell v. Dairymen's League Coop. Ass'n*, 22 N.J. Misc. 171, 37 A.2d 420 (1944); *Mayer v. Roche*, 77 N.J.L. 681, 75 Atl. 235 (1909).

³² *Sterret v. Stoddard Lumber Co.*, 150 Ore. 491, 46 P.2d 1023 (1935); *United Bank & Trust Co. v. McClough*, 115 Neb. 327, 212 N.W. 762 (1927); *Philip Carey Co. v. Maryland Cas. Co.*, 201 Iowa 1063, 206 N.W. 808 (1926); *Pollak v. Danbury Mfg. Co.*, 103 Conn. 553, 131 Atl. 426 (1925).

³³ See, e.g., *Gaston, Williams & Wigmore of Canada, Ltd. v. Warner*, 260 U.S. 201 (1922); *Pritchard v. Norton*, 106 U.S. 124 (1882); *United States-Alaska Packing Co. v. Uketa*, 58 F.2d 944 (1932); *Garrigue v. Keller*, 164 Ind. 676, 74 N.E. 523 (1905); *Wilson v. Lewiston Mill Co.*, 150 N.Y. 314, 44 N.E. 959 (1896). In *Green v. Northwestern Trust Co.*, 128 Minn. 30, 150 N.W. 229 (1914), it is stated that the presumed intention of the parties that the law of a particular state shall be governing will be given effect only when that state has a vital connection with the transaction or where the elements of the contract important in determining the governing law have their situs in such state.

³⁴ GOODRICH, *op. cit. supra* note 26, at 330.

³⁵ 2 BEALE, *op. cit. supra* note 25, at 1079-86. GOODRICH, *op. cit. supra* note 26, at 326-27. *Green v. Northwestern Co.*, 128 Minn. 30, 150 N.W. 229 (1899), and *Grand v. Livingston*, 4 App. Div. 589, 98 N.Y. Supp. 490 (1896), point out that the parties do not usually consider what law will govern their contract before they enter into it.

³⁶ RESTATEMENT, CONFLICT OF LAWS §§ 332, 358 (1934).

courts have decided that neither the place of making nor the place of performance is conclusive as to the law which the parties intended or may fairly be presumed to have intended, but that both are important indicia to be considered, along with other relevant circumstances.³⁷

If the note in the assumed problem provided that the law of the state in which the maker resided would govern, this test would give it effect, notwithstanding the fact that it was payable in the payee's jurisdiction. Since we assumed that the maker and co-maker resided in a state following the minority rule, the payee would be subject to any of the personal defenses which the co-maker may have against him.

D. Grouping of Contacts

This test is somewhat newer than the others, and it is perhaps the logical extension of the "intention" test. It is variously known as the "center of gravity" or "grouping of contacts" theory of the conflict of laws. Rather than making what generally amounts to a calculated guess in determining which law the parties apparently intended to control their rights and obligations, the court determines which law the parties "should" have intended. Consequently, emphasis is placed upon the law of the jurisdiction "which has the most significant contacts with the matter in dispute."³⁸ This theory was originally formulated in *W. H. Barber Co. v. Hughes*³⁹ as follows: "The court will consider all acts of the parties touching the transaction in relation to the several states involved and will apply as the law governing the transaction the law of that state with which the facts are in most intimate contact." In applying this test, the court said:

Looking for the contact points in the present case, we observe first that the parties were at all times engaged in purely business transactions. They transacted this business almost exclusively in Illinois. The accumulated indebtedness . . . arose solely from Illinois transactions. The place of their conferences to arrive at a settlement was in Illinois. The note was payable in Illinois. It was on an Illinois form. It was prepared in Illinois. It was valid in that state and was there to be performed. It was actually intended that Illinois law control, as expressly found by the court. On the other hand the only contact points with Indiana were the residence of the debtors, their signing of the note in Indiana and their placing it in the mail in Indiana. Considering all these circumstances it is impossible to escape the conclusions that the transaction centered in the State of Illinois and that its law should be applied to the note. . . .⁴⁰

This theory was used in the New York case of *Auten v. Auten*⁴¹ in determining the applicable law in matters bearing upon the execution, interpretation, validity, and performance of a contract. Reference was made to the *Barber* case and *Rubin v. Irving Trust Co.*⁴² as resorting to this method to rationalize the results reached by the courts in decided cases. In *Global Commerce Corp. v. Clark-Babbitt Industries, Inc.*⁴³ the Second Circuit cited *Auten v. Auten* as explicitly accepting ". . . what was apparently an already existing change in the earlier doctrine that the validity of a contract depends on the law of the place where the parties make their agreement."⁴⁴ The federal court went on to say:

We must accept the substituted concept as authoritative; and, so far as we can gather, the test appears to be (1) what is the "center of gravity" of the facts, or (2) which jur-

³⁷ *Joffe v. Bonne*, 14 F.2d 50 (3d Cir. 1926); *Mayer v. Roche*, 77 N.J.L. 681, 75 Atl. 235 (1909); *Wilson v. Lewiston Mill Co.*, 150 N.Y. 314, 44 N.E. 959 (1896).

³⁸ *Rubin v. Irving Trust Co.*, 305 N.Y. 288, 113 N.E.2d 424, 431 (1953). See also, *Jensen v. Swedish Am. Line*, 185 F.2d 212 (1st Cir. 1950); Harper, *Policy Bases of the Conflict of Laws: Reflections on Reading Professor Lorenzen's Essays*, 56 YALE L.J. 1155, 1161-68 (1947).

³⁹ 223 Ind. 570, 63 N.E.2d 417, 423 (1945). Although this case is generally given credit for being the first case to base its decision on this theory, the earlier case of *Jones v. Metropolitan Life Ins. Co.*, 158 Misc. 466, 286 N.Y. Supp. 4 (1936) discusses it along with the other theories in determining the applicable law.

⁴⁰ *W. H. Barber Co. v. Hughes*, *supra* note 39, at 423-24. This rule was immediately followed in *Spahr v. P. & H. Supply Co.*, 233 Ind. 592, 63 N.E.2d 425 (1945).

⁴¹ 308 N.Y. 155, 124 N.E.2d 99 (1954).

⁴² 305 N.Y. 288, 113 N.E.2d 424 (1953).

⁴³ 239 F.2d 716 (2d Cir. 1956).

⁴⁴ 239 F.2d at 719.

isdiction "has the most significant contacts with the matter in dispute," or (3) which is "most intimately concerned with the outcome of [the] particular litigation," or (4) "whether one rule or the other produces the best practical results."⁴⁵

In the example under consideration—that is, where the payee is suing a co-maker whose signature was procured by fraud—assume that the note was found to be made in the minority state because the contract was completed there by placing it in the mail at the request of the payee and that it was to be performed in the majority state because it was payable there. Assume further that the note is in payment of a debt which arose out of various contracts of sale, all of which were made in the majority state, and that the goods contracted for were all delivered in that state for use there. Under this test, the significant contacts are emphasized instead of regarding the parties' intention or the place of making or performance as conclusive.⁴⁶ Therefore, it seems likely that the court would find that the majority state had the greatest interest in the outcome and apply its law; it follows that the payee's position as a bona fide holder for value would be protected.

III. SECTION 1-105—A DIFFERENCE IN RESULT

In opposition to the NIL, the Code expressly sets out a provision as to its territorial application:

[W]hen a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state.⁴⁷

This "appropriate relation" test appears at first glance to be similar to the "grouping of contacts" test. This is not necessarily so, however, as a court could find that the place of making or performance, or the parties' intention was an "appropriate relation."

If suit is brought in a state operating under the Code, the Code is applied only when the forum finds an "appropriate relation" with the Code state. If the court finds no such relation, it would then fall back on common law conflicts principles to determine which state law is applicable. Thus, the adoption of the Code by a state would not vary the rules formerly used to determine applicable law as long as no "appropriate relation" were found between the total transaction and the Code state wherein the action was commenced. A possible difference could easily arise if an "appropriate relation" were found. For instance, a state, prior to adoption of the Code, might have followed the rule that the law to be applied in a negotiable instruments conflict problem was determined by the place of making. In the example previously used of the makers mailing a note from a minority-rule state at the request of the payee, the contract would be considered "made" in that state and, consequently, the court, in applying that state's law, would hold that a payee could not be a holder in due course. However, with the adoption of the Code, the same court would apply the "appropriate relation" test, and the forum might well decide that the place of making in the minority-rule state would not be determinative because there was an "appropriate relation" with the Code state. If suit were brought in a majority rule state, that state might have to apply the minority rule by virtue of its conflicts rules, and, therefore, a result different from the determination of the Code state, under the same circumstances, might obtain. Thus, under the Code it would be easier for the court to find that the payee could be a holder in due course since it would not be bound by the more rigid general rules such as the place of making. What constitutes an "appropriate relation" is left entirely to the discretion of the courts, and much depends on how far Code courts will go in finding appropriate relations, and establishing a policy of either extensive or narrow Code application.⁴⁸

⁴⁵ 239 F.2d at 719.

⁴⁶ *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99, 101-02 (1954).

⁴⁷ UNIFORM COMMERCIAL CODE § 1-105(1).

⁴⁸ What this judicial policy will be is difficult to predict. Certainly, much will depend upon the type of state that adopts the Code—commercial, industrial or agricultural. However, it seems that if a state legislature sees fit to enact the Code, the state courts should, within constitutional limitations, apply the Code in every available situation so as to best give significance to what is apparently

IV. THE SCOPE OF COVERAGE

Initially, before discussing the substantive innovations, it will be helpful to determine if there is any appreciable difference in the commercial area encompassed by the NIL and the Code respectively. Should there be such a difference this, in itself, would give rise to conflicts of laws, and would be resolved by a judicial implementation of the conflicts rules discussed above.

A. Scope of the NIL

Section 1 of the NIL states, "An instrument to be negotiable *must* conform to the following requirements. . . ."⁴⁹ (Emphasis added.) These prerequisites of negotiability, as set out in the first nine sections of the NIL, have given rise to conflicting interpretations as to the necessity of strict application and enforcement of section 1. Britton interprets this provision as demanding strict compliance if there is to be negotiability,⁵⁰ and contends that this has been an important factor in achieving the comparative uniformity which is now found in our commercial law. Beutel, to the contrary, is of the opinion that the language of section 1 is not mandatory.⁵¹ Without arguing the merits of either view, it is clear that the confusion has carried into the courts and led to inconsistent results. It has led courts, in some instances, to refuse limited negotiability to order instruments dealt with on the investment market,⁵² while other courts have upheld the negotiability of instruments which were actually conditional sales contracts thinly disguised as promissory notes.⁵³

Under the NIL, a minority of courts has evolved a doctrine of "negotiability by contract," holding that the parties to a commercial instrument that does not conform to the formal requisites for negotiable paper may impart to it all or some of the incidents of negotiability by an agreement in the contract to that effect.⁵⁴ Others have recognized the doctrine in dictum.⁵⁵ In *Aaron v. Mango*,⁵⁶ a Wisconsin court in effect applied a doctrine of negotiability by contract to a bond which, though conditioned on promises to repair and pay taxes, contained a provision describing the rights of a holder in due course. The provision stated:

No purchasers before maturity of any of said bonds shall, as to the lien which this Indenture purports to effect, be affected, unless he have actual knowledge thereof, by any equities that might at any time exist between the Mortgagors and the Trustees or between the Mortgagors or the Trustees and any previous holder or owner of such bond or bonds.⁵⁷

The court held that because of this provision the bonds, in the hands of an innocent purchaser, were not subject to a defense of partial failure of consideration, even though the bonds were otherwise non-negotiable.

the will of the people. If the Code states were not to apply the Code whenever possible, why was § 1-105 included at all? And see comment 3, following § 1-105: "In deciding [what relation is appropriate], the court is not strictly bound by precedents established in other contexts."

⁴⁹ UNIFORM NEGOTIABLE INSTRUMENTS LAW § 1.

⁵⁰ Britton, *Formal Requisites of Negotiability—The Negotiable Instruments Law Compared with the Proposed Commercial Code*, 26 ROCKY MT. L. REV. 1 (1954).

⁵¹ Beutel, *Negotiability by Contract*, 28 ILL. L. REV. 205 (1933).

⁵² *Manhattan Co. v. Morgan*, 242 N.Y. 38, 150 N.E. 594 (1926) (interim certificates); *King Cattle Co. v. Joseph*, 158 Minn. 481, 198 N.W. 798 (1924) (corporate bonds); *Manker v. American Savings Bank & Trust Co.*, 131 Wash. 430, 230 Pac. 406 (1924) (municipal bonds). In all these cases the rights of a subsequent bona fide purchaser were defeated because the instrument did not meet the requirements of the NIL.

⁵³ Conditional sales contracts are usually held to be non-negotiable because they promise no sum certain. For an illustration of such an agreement successfully incorporated into a promissory note without destroying negotiability, see *Abingdon Bank & Trust Co. v. Shipplett-Moloney Co.*, 316 Ill. App. 79, 43 N.E.2d 857 (1942). *Contra*, *Fleming v. Sherwood*, 24 N.D. 144, 139 N.W. 101 (1912).

⁵⁴ *Morgan Bros. v. Dayton Coal & Iron Co.*, 134 Tenn. 228, 183 S.W. 1019 (1916); see Note, *Negotiability By Contract, Estoppel or Usage*, 25 COLUM. L. REV. 209 (1925).

⁵⁵ *Manhattan Co. v. Morgan*, 242 N.Y. 38, 150 N.E. 594, 598, (1926); see also *Enoch v. Brandon*, 249 N.Y. 263, 164 N.E. 45, 46 (1928).

⁵⁶ 207 Wis. 583, 242 N.W. 138 (1932).

⁵⁷ *Id.* at 140.

We perceive no reason for holding that the provision above recited was not contractual or not fully binding upon the defendants. We do not see how its validity or legality as a contract can be questioned, nor do we perceive any ground of public policy of the state of Illinois which prevents our giving it full force and effect.⁵⁸

Utah has also adopted a doctrine of promissory negotiability. In *Anglo-California Trust Co. v. Hall*⁵⁹ the court held that in the absence of fraud the purchaser in a conditional sales agreement could, by contract, waive the defenses on a non-negotiable instrument, the defense in this instance being a breach of warranty. No authorities were cited by the court to sustain its position. The contract provision in the controversy stipulated:

. . . [I]n the event the seller shall assign and transfer this agreement . . . , then the purchaser shall be precluded from in any manner attacking the validity of this agreement on the grounds of fraud, duress, mistake, want of consideration, or upon any other ground, and the moneys payable hereunder by the purchaser shall be paid to such assignee or holder without recoupment, set-off, or counter-claim of any sort whatsoever.⁶⁰

Some jurisdictions have expressly rejected the theory of negotiability by contract.⁶¹ Others, meanwhile, have abstained from an obiter expression on this issue,⁶² distinguishing the *Hall* case on the ground that the defense there was not based on fraud or failure of consideration, and deciding that it would be contrary to public policy to waive such a defense.

In the cases discussed where negotiation by contract was allowed, the court did not confer upon the non-conforming instruments all the attributes of negotiability, such as the presumption of consideration and value. They merely gave effect to provisions waiving defenses and equities and this vested the bona fide purchasers of the paper with the rights of holders in due course.⁶³

B. Scope of the Code

Article three of the Code, by the terms of section 3-103, does not apply to money, documents of title, or investment securities. Additionally, section 3-104 provides that "Any writing to be a negotiable instrument *within this Article must. . .*" (Emphasis added.) It goes on to make it clear that the article applies only to commercial paper by specifying the four types of commercial paper covered. The comment following section 3-104 interprets the words "within the Article" as leaving open "the possibility that some writings may be made negotiable by other statutes or by judicial decision." However, the comment goes on to explain that an instrument cannot be made negotiable within the article by contract or by conduct. It is within the discretion of the court to arrive at a result similar to that of negotiability by finding that the obligor is estopped by his conduct from asserting a defense against a bona fide purchaser. Such an estoppel would depend upon the ordinary principles of contract law and not upon any extension of the accepted concept of negotiability.⁶⁴ From this it would appear that the Code will not allow its provisions to be applied by contract to non-conforming instruments in any situation, regardless of the equities of the case. Since under the NIL this could be done as illustrated in the cases discussed above, we have a situation which, until the Code becomes a truly uniform law among the states, could prove a fertile pasture for the growth of conflicts problems.

C. Resolution of the Problem—A Basic Conflict

The solutions offered by the NIL and the Code to resolve these conflicts also differ. Since the NIL contains no provision dealing with the problem of conflicts, resort

⁵⁸ *Id.* at 141.

⁵⁹ 61 Utah 227, 211 Pac. 991 (1922).

⁶⁰ *Id.* at 992.

⁶¹ *American Nat'l Bank v. Somerville*, 191 Cal. 364, 216 Pac. 376 (1923).

⁶² *Pacific Acceptance Corp. v. Whalen*, 43 Idaho 15, 248 Pac. 444 (1926). *Contra*, *Howie v. Lewis*, 14 Pa. Super. 232, 240 (1900), holding that a defense of fraud could be waived.

⁶³ *Howie v. Lewis*, *supra* note 62.

⁶⁴ UNIFORM COMMERCIAL CODE § 3-104 and comments.

is had to common law rules and principles which the various states have formulated over a period of years. In determining negotiability, the courts have generally used one of four tests, all of which have been fully discussed earlier in the Note: place of execution, (*lex loci contractus*),⁶⁵ place of performance (*lex loci solutionis*),⁶⁶ intention of the parties⁶⁷ and "grouping of contacts."⁶⁸ All of these tests apparently seek to give life to that law which the parties contemplated at the time of the transaction. The Code, on the other hand, both in the original draft as enacted by Pennsylvania and in the revised draft as adopted by Kentucky and Massachusetts, contains a provision on the applicability of the Code. The Pennsylvania statute provides:⁶⁹

(3) The Articles on Commercial Paper (Article Three) and Bank Deposits and collections (Article Four) apply whenever any contract or transaction within the terms of either of the Articles is made or occurs after the effective date of this Act and the contract (a) is made, offered or accepted or the transaction occurs within this state; or (b) is to be performed or completed wholly or in part within this state; or (c) involves commercial paper which is made, drawn, or transferred within this state.

A number of authorities felt this provision to be too harsh,⁷⁰ and it was subsequently revised to allow the application of the Code only when the transaction bears an "appropriate relation" to the Code state.⁷¹ The original provision was further qualified to the extent that when the transaction bears a reasonable relationship to the state in which the Code is in effect and also to another state, the parties may stipulate which law is to govern. In the absence of such stipulation the Code applies.⁷²

When the aforementioned rules are applied to the conflicts problems arising out of the restricted scope of the Code, a lack of uniformity is found in the result achieved. For the purpose of this Note, let us assume that A, in Utah executes and delivers to B commercial paper that does not conform to the requirements of the NIL. This instrument contains an agreement whereby A agrees not to assert any defense against a subsequent holder or assignee, which is the type of agreement upheld in *Anglo-California Trust Co. v. Hall*⁷³ and which Beutel contends is permitted under the NIL. Let us further assume that the instrument states it is to be performed in Utah and concerns a transaction in Utah. B takes the instrument into Michigan where he transfers it to C, who takes for value and without notice of any defect in the instrument. Subsequently there is a breach of warranty by B, and A attempts to raise this as a defense in an action brought by C in Michigan. A fair conclusion would be that regardless of which state operating under the NIL the action is brought in, the courts would look to the law of Utah to determine whether or not the paper was negotiable, and so preclude the use of personal defenses against C, a holder in due course.⁷⁴ It was in that state that the instrument was executed and delivered; it is certainly a fair assumption that the parties contemplated Utah law at the time of the transaction; and there are no reasonable contacts with another state which would warrant the application of its law. If the same paper were passed into Kentucky or Massachusetts, both of which operate under the

⁶⁵ *Alropa Corp. v. King's Estate*, 279 Mich. 418, 272 N.W. 728 (1937).

⁶⁶ *Jefferis v. Kanawha Fuel Co.*, 182 Wis. 203, 196 N.W. 238 (1923); *Walling v. Cushman*, 238 Mass. 62, 130 N.E. 175 (1921).

⁶⁷ *Mayer v. Roche*, 77 N.J.L. 681, 75 Atl. 235 (1909).

⁶⁸ *W. H. Barber Co. v. Hughes*, 223 Ind. 570, 63 N.E.2d 417 (1945).

⁶⁹ PA. STAT. ANN. tit. 12A, § 1-105 (1954).

⁷⁰ See *Panel Discussion On The Uniform Commercial Code*, Bus. Law, Nov. 1956, p. 49, 68-75; *Smith, Conflicts and Chaos or Contract and Uniformity: The Uniform Commercial Code*, 2 KAN. L. REV. 11 (1953).

⁷¹ UNIFORM COMMERCIAL CODE § 1-105.

⁷² *Ibid.* It also states in the comments to this section ". . . an agreement as to choice of law may sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen." The real meaning of this provision is hazy and could well lead to difficult problems of interpretation.

⁷³ 61 Utah 227, 211 Pac. 991 (1922).

⁷⁴ *Ellis v. Crowe*, 193 Ark. 255, 99 S.W.2d 568 (1936); *Stevens v. Gaude*, 9 La. App. 664, 120 So. 79 (1928). A more complete discussion of this is provided in an earlier part of the Note, pp. 211-13 *supra*.

Code, there appears to be no reason to anticipate a different result. These states would be justified in applying the Code only if the transaction bears an "appropriate relation" to the state,⁷⁵ which seemingly does not exist in our example. This would not seem open to argument, since under the original draft, as enacted by Pennsylvania, the act of transferring an instrument within the state was the *least* contact with the state which would demand the application of the Code; therefore, if the revision actually curtailed to any extent the scope of the original section 1-105, it would not allow the mere transfer of an instrument to be an appropriate relation. Also, the identical situation is dealt with in the comments to the revised section 1-105, wherein it is stated that there is not an appropriate relation when the parties have clearly contracted on the basis of some other law, "as where the law of the place of contracting and the law of the place of contemplated performance are the same and are contrary to the law under the Code." Therefore the Code would not be applied, and by common law these states would look to Utah for determination.⁷⁶ However, were the instrument negotiated to C in Pennsylvania, and the action instituted there the Code expressly states that it be applied.⁷⁷ In such event, C's interest would be destroyed for the Code treats such an instrument as non-negotiable, and this seems contrary to the intent of the parties at the time of the transactions.

To develop this further, let us change our hypothetical situation. Let us now assume that A, a buyer, in payment for goods sold to him by B, executes and delivers to B in Pennsylvania a conditional sales contract wherein he waives all defenses. This agreement is to be performed in Mississippi and evolves out of a transaction in Kentucky. This is in turn transferred by B to C, in another state, who, when he attempts to recover as a holder in due course, is met with the defense of breach of warranty. Within the courts operating under the NIL, there might well be achieved a difference of result. When the place of payment is stated in the instrument, courts generally recognize the law of that jurisdiction as the law which the contracting parties contemplated as controlling.⁷⁸ In such courts the negotiability would in all probability be determined by the law of Mississippi. The issue of negotiability of a conditional sales contract has not been presented to the Mississippi courts, but in light of the decision in *Alder v. Interstate Trust & Banking Co.*⁷⁹ there is a strong probability that the note would be declared negotiable. However, were the action brought in New York⁸⁰ or Indiana,⁸¹ where the test is that of "grouping of contacts," there is a possibility that the court would find sufficient contacts with Kentucky, that being the situs of the transaction, to warrant applying the Code, and thus require a declaration of non-negotiability. Again, if the action were brought in either Massachusetts or Kentucky it appears that the result would be no different from that reached by some courts under the NIL. It would fall to the Kentucky court to determine if there exists an appropriate relation with the state. It appears likely from the comments following section 1-105 that such an appropriate relation would clearly be present in the hypothetical situation posed. If so, the Code would be applied and C's interest destroyed. If no such relationship is found, the Kentucky and Massachusetts courts would revert to the common law and look to Mississippi for adjudication.⁸² Pennsylvania, regardless of the implied intent of the parties and common

⁷⁵ A more complete discussion of the "appropriate relation" test is provided in p. 215, *supra*.

⁷⁶ *Deins' Adm'r v. Gibbs* 257 Ky. 469, 78 S.W.2d 346 (1935); *Walling v. Cushman*, 238 Mass. 62, 130 N.E. 175 (1921).

⁷⁷ PA. STAT. ANN. tit. 22A, § 1-105 (1945), ". . . involves commercial paper which is . . . transferred . . ."

⁷⁸ *Carson Nat'l Bank v. American Nat'l Bank*, 225 Mo. App. 948, 34 S.W.2d 143 (1931); *Commercial Credit Corp. v. Boyko*, 103 N.J.L. 620, 137 Atl. 534 (1927).

⁷⁹ 166 Miss. 215, 146 So. 107 (1933). This case concerned a waiver clause that was not in the note itself, but in the trust deed given as security for it. It was held to be negotiable.

⁸⁰ *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954).

⁸¹ *W. H. Barber v. Hughes*, 233 Ind. 570, 63 N.E.2d 417 (1945).

⁸² Under the rule of *Deins' Adm'r v. Gibbs*, 257 Ky. 469, 78 S.W.2d 346 (1935) and *Banca Italiana Di Sconto v. Columbia Counter Co.*, 252 Mass. 552, 148 N.E. 105 (1925), both Kentucky and Massachusetts look to the law of the place of performance to resolve such conflicts.

law rules to the contrary, would apply the Code simply because the instrument was executed there.

This analysis presents an interesting situation which deserves consideration. If the action is brought in a non-Code state, whose substantive law adheres to the general view that there can be no negotiability in the situation discussed, under the general rule of conflicts such a state will still give effect to the minority position that negotiability can be created by contract. This is so in a Code state only if there is no "appropriate relation." What contacts will be deemed "appropriate" has not been definitively stated. However, the revised section 1-105 seemingly allows a court in a Code state great latitude in finding such an appropriate relation so that it might avoid giving effect to the view that there can be negotiability by contract. Such a practice would greatly aid the expansion of the Code since it would cause the Code to be applied in situations which at common law could be governed by the law of another state, even though it is substantially different from the law of the jurisdiction wherein the action is brought.

V. INNOVATIONS IN THE FORMAL REQUISITES OF NEGOTIABILITY

In addition to this possible variance in scope of application, there are several substantive innovations in the Code as regards formal requisites of negotiability. Under the NIL an instrument, to be negotiable, must conform to the requirement, *inter alia*, that it contain an order to pay a sum certain in money.⁸³ The application of this term in deciding individual cases has produced a variety of results. There are some decisions to the effect that a provision in the instrument providing for a discount upon payment at or before maturity does not affect its negotiability.⁸⁴ Other courts have taken the view that such a provision renders the note non-negotiable due to its uncertainty of amount payable.⁸⁵ The drafters of the Code have removed any doubts on the point. Code section 3-106 states that the sum payable is a sum certain even though it is payable with a stated discount or addition if paid before or after the date fixed for payment; the test for certainty being computability from the instrument itself at the time of payment.

Still another formality required of a negotiable instrument under the NIL is that it be payable on demand, or at a fixed or determinable future time.⁸⁶ The Code adopts the language "definite time" in lieu of "determinable future time,"⁸⁷ and reverses the position taken by section 4(3) of the NIL which states that negotiability is not destroyed if performance is to be had on an event certain to happen though uncertain as to when. Under the Code, an instrument is not payable at a definite time unless the time of payment can be determined from the face of the instrument. Thus a note payable one year after the death of the maker, or one year after the war is over, will no longer be negotiable.⁸⁸

A different aspect of the same problem is raised by acceleration and extension clauses. Various types of acceleration clauses may exist,⁸⁹ and all need not be herein considered. However, those clauses which give to the holder the option to accelerate the maturity date of the instrument have received inconsistent treatment under the NIL. The weight of authority has sustained negotiability where the operation of the clause depends upon the occurrence of an event bearing a close relation to the problem of col-

⁸³ UNIFORM NEGOTIABLE INSTRUMENTS LAW § 1(2).

⁸⁴ Capitol City State Bank v. Swift, 290 Fed. 505 (E.D. Okla. 1923); Commercial Credit Co. v. Nissen, 49 S.D. 303, 207 N.W. 61 (1926).

⁸⁵ Waterhouse v. Chovinar, 128 Me. 505, 149 Atl. 21 (1930); First Nat'l Bank v. Watson, 56 Okla. 495, 155 Pac. 1152 (1916).

⁸⁶ UNIFORM NEGOTIABLE INSTRUMENTS LAW § 1(3).

⁸⁷ UNIFORM COMMERCIAL CODE § 3-109.

⁸⁸ Under the NIL, a note to be paid at a specified time after death is held to be negotiable. *Murrell v. Gibbs' Adm'r*, 275 Ky. 124, 120 S.W.2d 1018 (1938).

⁸⁹ *Road Improvement Dist. No. 1 v. Bank of Commerce & Trust Co.*, 169 Ark. 43, 272 S.W. 834 (1925) (accelerable by maker); *McCornick & Co. v. Gem State Oil & Products Co.*, 38 Idaho 470, 222 Pac. 286 (1923) (accelerable by the happening of a specific event); *Hollingshead v. John Stuart & Co.*, 8 N.D. 35, 77 N.W. 89 (1898) (accelerable by the holder).

lections.⁹⁰ On the other hand, a clause giving the holder the option to mature the instrument when he "deems himself insecure" has been held to destroy negotiability.⁹¹ Article three, section 3-109, settles the question by permitting all types of acceleration. The justification for this view is that since demand instruments are accelerable at the option of either party, uncertainties as to time and amount should be equally unobjectionable when a time instrument is involved. In fact the latter instrument, having an ultimate due date, is least objectionable on this count. To guard against abuse of discretion by the holder, the Code provides:⁹²

A term providing that one party . . . may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.

Extension clauses bear a close relationship to acceleration. A note may be made payable two years after date, with an option in the maker to pay on or before that date. The same transaction might be handled by making the note payable one year after date, with an option in the maker to extend the payment one year. Both should be negotiable. On the other hand, a note which gives an option to the maker to renew it at will for an indefinite period would clearly violate the rule as to certainty of time. Hence section 3-109 of the Code provides that an extension to a further definite time at the option of the maker or automatically upon a specified act or event will not make the time of payment indefinite. In brief, the purpose of the section is to clear away uncertainties under the NIL relating to acceleration and extension clauses and eliminate objectionable instruments that do not in fact have free circulation in commerce.

In that they are requisites for negotiability, conflicts arising from these differences are governed at common law by the same tests as related to the previously posed hypothetical situations. Assume A resides in Kentucky, and because of a transaction in Tennessee, makes a note with a discount rate of 2% if paid before a specified event. This then is delivered to B in Tennessee, wherein the note states it is to be performed. B subsequently transfers the note to C. When C attempts to recover he is met with a personal defense which A has against B. Should jurisdiction over A be grounded in Tennessee, the conflict over what state law should be applied would be controlled by *Edgington v. Edgington*⁹³ where effect was given to the law of the place of performance. Therefore, the law of Tennessee would be determinative and by virtue of the rule laid down in *Farmer's Loan & Trust Co. v. Deaver, Hair & Co.*,⁹⁴ the note would be declared non-negotiable due to uncertainty of amount. Such a result does not appear to be unreasonable. All the contacts of the note, with the exception of the making, occurred in Tennessee, and it was within that state that it was accepted by C. This leads to the reasonable presumption that Tennessee law was contemplated by the parties as controlling, or at least was anticipated as the controlling jurisdiction.

Would the court's determination of C's interest be different were the action brought in Kentucky? The answer to this question is "yes" if the court finds the Code applicable, for, as stated in section 3-106, such a discount rate does not affect negotiability. However, before the Code can be applied so as to reach this contrary decision, the court must first find an "appropriate relation" with the state. The only relation with Kentucky in our hypothetical is the fact that the note was made there. Whether the court would find the mere making of the note to be an "appropriate relation" cannot be ascertained with certainty. However, there appears to be little justification for such a

⁹⁰ See Chafee, *Acceleration Provisions in Time Paper*, 32 HARV. L. REV. 747 (1919).

⁹¹ *First State Bank v. Barton*, 129 Okla. 67, 263 Pac. 142 (1928); *Puget Sound State Bank v. Washington Paving Co.*, 94 Wash. 504, 162 Pac. 870 (1917).

⁹² UNIFORM COMMERCIAL CODE § 1-208.

⁹³ 179 Tenn. 83, 162 S.W.2d 1082 (1942).

⁹⁴ 2 Tenn. Civ. App. 366, Am. & Eng. Ann. Cas. 1918B 603 (1911).

holding. It seems more likely that Kentucky would not apply the Code, but rely upon its rules of conflicts, thereby looking to the law of Tennessee.⁹⁵

Now let us add one more step to our hypothetical situation. Assume that C carries the note into Pennsylvania whereupon he transfers it to D. From the original transaction there is nothing to indicate that A or B did foresee, or even that they should have foreseen, that the note would pass into Pennsylvania; nor that they intended the law of Pennsylvania to apply to their transaction. D now is in a very advantageous position. In an action, the Pennsylvania courts will not look back to the intent of the original parties, nor will they look to the state, Tennessee, which is the most closely connected with the transaction. Rather, simply because the instrument was transferred within its borders, they will look to their own law, the Code, and declare the note negotiable. This appears to be an arbitrary result which completely disregards the intent of the parties. It is in effect a law of substitution.

Conclusion

From the foregoing, it appears that the adoption of the Code brings into life several additional areas of conflicts. First, the states differ in interpreting some provisions of the NIL, such as, for example, whether a payee can be a holder in due course; and secondly, although the Code usually adopts the majority interpretation, the discretion allowed the courts by virtue of the "appropriate relation" test may produce different results when suit is brought in a Code state from the resolution of the same problem in a suit brought in a majority-rule jurisdiction. That there has been a lack of uniformity in conflict of law principles in regard to commercial paper is evident. Until the Code is adopted in all states, there is no reason to expect a greater degree of uniformity. Some courts will continue to apply such tests as place of contracting and place of performing.⁹⁶ These tests have the desirable attribute of certainty which is of prime importance in the commercial field. Since the bulk of a lawyer's work and his greatest responsibility in this area is to advise his client as to future conduct, this practical attribute allows him to do so in reference to a fixed and well-settled body of law.

Other courts will apply the more modern "grouping of contacts" test which lays emphasis upon the law of the place "which has the most significant contacts with the matter in dispute."⁹⁷ This test may diminish the area of reasonable predictability, since it is within the discretion of the court to determine which state has the most reasonable contacts with the transaction. Because there are often significant contacts in many states, the question of which particular state's law should measure the obligation seldom lends itself to simple solution by means of mechanical formulae of the conflicts of law. Nevertheless, stressing the relevant contacts enables the forum to apply the law of the jurisdiction most intimately concerned with the outcome of the particular litigation.⁹⁸ The court is allowed to exercise ". . . informed judgment in the balancing of all the interests of the states with the most significant contacts in order best to accommodate the equities among the parties to the policies of those states."⁹⁹ This test also gives consideration to the probable intention of the parties and gives the court a wider discretion, enabling it to apply the law which upholds the transaction.¹⁰⁰

⁹⁵ *Deins' Adm'r v. Gibbs*, 257 Ky. 469, 78 S.W.2d 346 (1935); *Banca Italiana Di Sconto v. Columbia Counter Co.*, 252 Mass. 552, 148 N.E. 105 (1925).

⁹⁶ Any attempt on the part of state courts arbitrarily to use these tests to avoid an application of the Code because it would contravene the public policy of the forum state, would be in violation of the Supreme Court's holding that foreign statutes must be enforced by the forum under the full faith and credit clause. *First Nat'l Bank v. United Air Lines*, 342 U.S. 396 (1952); *Hughes v. Fetter* 341 U.S. 609 (1951).

⁹⁷ *Rubin v. Irving Trust Co.*, 305 N.Y. 288, 113 N.E.2d 424, 431 (1953).

⁹⁸ *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99, 102 (1954).

⁹⁹ *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 162 (1946).

¹⁰⁰ See *Global Commerce Corp. v. Clark-Babbitt Industries, Inc.*, 239 F.2d 716 (2d Cir. 1956); *Mutual Life Ins. Co. v. Simon*, 151 F. Supp. 408 (S.D.N.Y. 1957); *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954); *Swift & Co. v. Bankers Trust Co.*, 280 N.Y. 135, 19 N.E.2d 992 (1939).

The "appropriate relation" test of the revised section 1-105 is applied where suit is brought in a jurisdiction which has adopted the Code. There is no way of knowing at this time what the courts will find to be an "appropriate relation." Any of the conflict principles discussed in this Note perhaps may be deemed to include such a relation. In addition there would appear to be nothing to prohibit the court from finding any of the contacts listed in the Pennsylvania statute to be an appropriate relation. The test would appear to lend itself to the possibility of further extension, until eventually declared unconstitutional. In fact, an appropriate relation will likely be considered by the Code courts to be any relation which, when used for grounding jurisdiction over the litigation, falls short of causing the application of the Code to be unconstitutional as a violation of full faith and credit or the contracts clause.¹⁰¹

State choice-of-law rules also may be subject to scrutiny by the Supreme Court if due process questions are raised.¹⁰² If the "appropriate relation" as found by the court is reasonable, and not arbitrary, it would appear to satisfy the constitutional requirements. In this regard, it is more difficult to reconcile section 1-105 as adopted by Pennsylvania. Under that provision, if one of the contacts enumerated occurs within Pennsylvania, all inter-related phases of the transaction become subject to the law of that jurisdiction regardless of the intent of the parties.

Since the notion of "appropriate relation" is unclear, there is also the possibility of different results in the application of section 1-105 by Code states. Because of the fact that each state is free to determine its own standards, they may well disagree as to when the Code, as opposed to the common law principles, should be utilized. Thus section 1-105 is not the panacea which will eliminate the present state of confusion found in the conflict of laws principles used in the area of commercial paper.

John F. Beggan
Alfred A. Kaelin

¹⁰¹ For a discussion of these clauses see Smith, *Conflicts and Chaos or Contract and Uniformity: The Uniform Commercial Code*, 2 KAN. L. REV. 11, 14-32 (1953-54).

¹⁰² See *Hartford Accident & Indemnity Co. v. Delta & Pine Land Co.*, 292 U.S. 143 (1934); *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930).