FEDERAL RESERVE BOARD

WASHINGTON

February 8, 1922.
X-3322

SUBJECT: Negotiability of Promissory Notes Secured by Chattel or Real Estate Mortgages.

Dear Sir:

For the information of Federal Reserve Banks, there is enclosed herewith a copy of the Board's letter to Governor Calkins, with reference to the negotiability of notes secured by chattel or real estate mortgages, together with copies of a brief resume, and detailed memorandum of law, on the same subject prepared by the Counsel to the Federal Reserve Bank of San Francisco.

Yours very truly,

Enclosures.

Governor

To Governors and
Federal Reserve Agents.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

C O P Y

FEDERAL RESERVE BOARD

Washington

X-3322a
February 2, 1922.

Mr. J. U. Calkins, Governor,
Federal Reserve Bank,
San Francisco, California.

Dear Governor Calkins:

Receipt is acknowledged of your letter of January 20, 1922, enclosing copy of a memorandum of law on the general subject of the negotiability of notes secured by mortgages, together with a brief resume thereof, both prepared by your counsel, Mr. Agnew.

The Board has submitted these memoranda to its counsel, who has gone over them with much interest. He states that the brief contains an excellent discussion of the question and a most helpful compilation of authorities, and that in his opinion, the other Federal reserve banks and their counsel would be very glad to be supplied with copies of both the brief and the resume. The Board will, therefore, circulate these memoranda among all Federal reserve banks. As you indicate in your letter, these memoranda will serve to impress upon the Federal reserve banks the legal uncertainties involved in dealing with certain kinds of paper and the importance of determining the state of law obtaining within their respective districts.

Under the conflicting state of authorities it is impracticable to make a general ruling covering all possible situations or to rule that mortgage secured notes originating or payable in certain States are or are not negotiable. Such questions of negotiability must be determined by reference to local laws and decisions and are, therefore, primarily for the determination of local counsel. In view of the fact that the courts of California and a few other States appear to have rejected the majority rule and to have held definitely that notes are non-negotiable if they recite that they are secured by chattel or real estate mortgages, the Board desires to call your attention to its former rulings to the effect that non-negotiable notes are ineligible for discount by Federal reserve banks. With respect, however, to notes the negotiability of which cannot be determined with reasonable certainty under the relevant statutes and court decisions, it seems proper for Federal reserve banks to assume that the majority rule would be held to apply, and the Board's former rulings need not, therefore, be construed to prohibit the discount of such notes. As pointed out in your counsel's memorandum, the question of what law governs the negotiability of a note is often a difficult one to decide.

Yours very truly,

(Signed) W. P. G. Harding,

G o v e r n o r.

WSL:B

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

C O P Y

FEDERAL RESERVE BANK
San Francisco

January 20, 1922.
X-3322b

SUBJECT: Negotiability of Promissory Notes Secured by Mortgages.

The rule of law in force in a majority of the states is that the negotiability of a promissory note, otherwise negotiable in form, is not affected by the fact that it is secured by a chattel or real estate mortgage. In most of the states, also, the mere fact that such negotiable note states upon its face that it is secured by mortgage, does not militate against its negotiability. The above rules are supported by the great weight of authority.

On the other hand, it is generally held that in those cases where a note, otherwise negotiable in form, in terms adopts the provisions of an accompanying mortgage, as where the note states that its payment is "subject to all the terms and conditions" of the mortgage, it is thereby rendered non-negotiable.

The majority rule above stated is followed in the United States courts in Alabama, Arkansas, Colorado, District of Columbia, Mississippi, New Jersey, New York, North Carolina, Oklahoma, Oregon, Texas, Washington, and many other states.

The majority rule is rejected in whole or in part in California, Illinois, Iowa, Kansas, Michigan, Minnesota, and Utah. In Idaho, Nevada and Arizona and several other jurisdictions, the question has never been directly presented for decision. In Missouri, Montana, Nebraska and Wisconsin, the decisions are in conflict and it is difficult to say what conclusion the courts of these states will reach when the question is again presented for interpretation under the terms of the Negotiable Instruments Act.

An explanation of the processes of reasoning by which the states following the minority rule have reached the conclusion that promissory notes, otherwise negotiable in form, are rendered non-negotiable when transferred to one having knowledge of the existence of an accompanying and supporting mortgage, cannot be undertaken within the scope of this memorandum.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The law of the place of contract or the place of payment generally governs the interpretation of the instrument. A note executed and payable in California, coming into the hands of a purchaser residing in New York will, as a general rule, be interpreted as to its negotiability in accordance with the law enunciated by the courts of California. In order, therefore, to determine the negotiable character of a note secured by mortgage, it will not suffice to rely upon the rule applying in the jurisdiction where the instrument is held, if the obligation originated or is payable in another jurisdiction. Reference, in such case, must be made to the law as set forth in the decisions of the courts of the state of origin or payment.

For a fuller discussion of this important phase of the law of negotiable instruments, reference is made to the accompanying brief.

(Signed) Albert C. Agnew,
Attorney.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

X-3322c

MEMORANDUM OF AUTHORITIES

IN RE

NEGOTIABILITY OF PROMISSORY NOTES SECURED BY MORTGAGES

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MEMORNADUM IN RE NEGOTIABILITY OF PROMISSORY NOTES

SECURED BY MORTGAGES

INTRODUCTION

The question of the negotiability of promissory notes secured by mortgages is one of considerable importance to Federal reserve banks. If the note is negotiable, although secured by mortgage, it is not subject, in the hands of an innocent purchaser for value before maturity, to any equities as between the mortgagor and the mortgagee. If, on the other hand, the court holds that the note is rendered non-negotiable, either by reason of the fact that it is secured by mortgage or by reason of some provision contained in the mortgage, it is subject in the hands of an innocent purchaser for value before maturity to any defenses which the mortgagor may have against the mortgagee. Thus, if the note is held to be non-negotiable, the Federal reserve bank which may have purchased the note in good faith and without notice of any defense to the payment thereof may, when suit is brought to effect collection through the foreclosure of the mortgage or otherwise, be confronted with a defense of fraud or failure of consideration which may partially or entirely defeat a recovery upon the debt.

WHAT LAW GOVERNS

An investigation of this subject necessarily involves also an investigation of the question as to what law will govern the interpretation of the contract involved in the execution and delivery of the note secured by mortgage. For instance, if the Federal Reserve Bank of San Francisco,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

132

by an assignment made in California, becomes the owner of a note executed in Illinois and secured by a real or personal mortgage upon property located in Illinois, the question of whether the negotiability or non-negotiability of such note is to be determined under the law of California or under the law of Illinois becomes vital.

The general rule is that a contract, as to its validity and interpretation, is governed by the law of the place where it is made - the lex loci contractus; or, more accurately speaking, that contracts are to be governed, as to their nature, validity and interpretation, by the law of the place where they were made, unless the contracting parties appear to have had some other place in view.

The law of the place of contract in general determines the negotiability of the instrument. This is especially true where the place of the contract as well as the place of payment are the same. In other words, a note secured by chattel or real estate mortgage, executed in Illinois and payable in Illinois, will, in the hands of a purchaser residing in California be interpreted as to its negotiability, not in accordance with the law of California, but in accordance with the law of Illinois. Where the place of payment is different from the place of contract, it is usual that the law of place of payment governs. Thus, under ordinary conditions a note secured by chattel or crop mortgage executed in Illinois but payable in California would be interpreted in accordance with the law of California. In some cases, however, the law of the place where the instrument is executed has been held to control rather than the law of the place of payment. This, however, is the exception to the rule. Where the question arises as between an indorser and the indorsee, it has been held that the contract would be

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

governed by the law of the place where the indorsement was made. On the other hand, however, the place of execution rather than the place of indorsement governs where the action is by an indorsee against the maker or the drawer. If a bill is negotiable by the law merchant, it is presumed to be negotiable by the law of the place of contract in the absence of proof to the contrary. As a general rule, the law of the place of contract governs the general liability of the maker, except in so far as controlled by the law of the place where the instrument is payable. If no particular place of payment is specified, the law of the place of contract governs. As a general rule, the liability of the maker to others or his right to set up an equitable defense will be unaffected by the law of the place of transfer.

Thus, it may be said to be the prevailing rule that a note secured by mortgage on chattels or real property executed in California and payable in California will be interpreted by the law of the place of execution, wherever the action may arise. It may also be said to be generally true that, in the absence of a definite statement as to where the obligation is payable, the contract will be governed according to the law of the State of California even though payment be demanded in another jurisdiction.

The determination of the question of what law shall govern becomes extremely important in interpreting the right of a maker of a note secured by mortgage, to equitable defenses against a bona fide purchaser for value before maturity, on account of the fact that the courts of the several states have reached widely different conclusions upon the subject and, on account of the fact that even in those jurisdictions the courts of which have held similarly, the processes of reasoning by which the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

conclusions are reached differ very widely. Herewith follows a brief resume of the decisions of the courts of several jurisdictions in regard to the negotiability of promissory notes secured by mortgages, the decisions of the United States courts being reviewed first; thereafter the decisions of the courts of the states embraced within the Twelfth Reserve District, and lastly the decisions of the courts of several other states not embraced in this district.

GENERAL RULE.

The doctrine has been laid down in a number of cases and is stated by Mr. Hilliard in his treatise on mortgages that, if a mortgage is given to sécure a negotiable note, and both the mortgage and the note are transferred for value before maturity to a bona fide indorsee, such indorsee takes the benefit of the mortgage as well as of the note, clear of any equities between the original parties. This doctrine, which may be said to be the majority rule, is based upon the theory that it is the debt which gives character to the mortgage and fixes the rights and remedies of the parties under it, and not the mortgage which determines the nature of the debt.

In many cases, however, this doctrine is denied on the ground that the mortgage is simply a chose in action, and is taken subject to the accounts between the mortgagor and the mortgagee and while it is an incident to the debt, the benefit of which, so far as the assignor is concerned, with it, the assignee cannot rely on the privileged character of the note to insure him the advantage of the mortgage.

The courts which have so held have generally reached the conclusion by stating that the assignee, having to resort to equity to enforce his rights, is compelled to do equity to the mortgagor and allow him the right of all defenses against the mortgage. Under this rule, although the purchaser of a

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

note before maturity takes it free of any equities existing between the original parties, yet, if it is secured by mortgage, the non-assignable character of the security qualifies his rights and remedies upon the note and makes it subject to all defenses and equities to which it would be liable in the hands of the assignor. Under this view, the rights of an assignee seeking to foreclose a mortgage are determined by the principles of equity applicable to non-negotiable instruments and not by the law merchant, and since a mortgage is a non-negotiable instrument, an assignee takes it subject to all equities and defenses between the original parties, even though the mortgage debt is evidenced by a negotiable promissory note transferred to the assignee for value, before maturity. This may be said to be the minority rule.

Jones on Chattel Mortgages, 7th Ed. par. 838.

This doctrine has been followed in Minnesota, Illinois, Ohio, Kansas and several other states, but in Illinois, where this rule has been followed, it is held not to apply to deeds of trust given to secure railroad coupon bonds intended to be thrown upon the market and circulated as commercial paper.

Peoria Railroad Co. vs Thompson, 103 Ill. 205.

Mr. Daniel in his work on Negotiable Instruments, (6th Ed. par. 834) disapproves of the doctrine last stated which subjects notes secured by mortgages to any defenses available by the mortgagor against the mortgagee and states that the former rule seems to be the equitable and just one. It is clear, however, that even the majority rule, that an innocent purchaser of a note secured by mortgage is protected against any equities existing in favor of the mortgagor, is subject to this limitation; that if the land or personal property covered by the mortgage was subject to a prior lien of a third party, the indorsee of the note would only acquire the right to enforce his claim against the land or personal property subject to such lien, whether he had

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

notice of it or not. This limitation arises from the very nature of the transaction, as the indorser himself could not, by a negotiable or other contract, supersede the pre-existing rights of a third person, not a party to his act. Thus, even in those states which hold to the strict rule of negotiability of notes secured by mortgage, it is held that wherever the assignee is chargeable with constructive notice of an equity prior to the mortgage under which he claims, he must yield to it.

The mere fact that a note is secured by a mortgage does not of itself affect its negotiability, except in California, and under these circumstances the assignment of the mortgage cannot affect the negotiability of the note. One class of cases holds that where a mortgage is delivered at the same time as the note, provision in the mortgage rendering the amount of the note or the time of payment uncertain, destroy the negotiability of the note in the hands of all persons charged with notice thereof, especially where the note expressly refers to the mortgage.

Jones V. Dulick (Kans. Apr.) 55 Pac. 522,
Brooke v. Struthers, 110 Mich. 562; 68 N. W. 272,
Cornish v. Woolverton, 32 Mont. 456; 81 Pac. 4
Roblee v. Union Stockyards National Bank, 69 Neb. 180; 95 N. W. 61;
Kendall v. Selby, 66 Neb. 60; 92 N. W. 178
Donaldson v. Grant, 15 Utah 231; 49 Pac. 779.

There are, however, many decisions holding to the contrary, and in which particular mortgage provisions which, if contained in the note, would destroy its negotiability, are held not to affect the negotiability of the note because they relate solely to the security.

The courts of many of the states have held that

temporaneously executed as part of the same transaction will be construed together. If, construing the instruments together, the mortgage imports into the note conditions which render it uncertain or otherwise violate the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

elemental principles of negotiability, the note will be rendered non-negotiable.

Brooke v. Struthers, 110 Mich. 562; 68 N. W. 272,
Cornish v. Woolverton, 32 Mont.456; 81 Pac. 4.

But construing together simply means that, if there be any provisions in one instrument limiting, explaining, or otherwise affecting the provisions of another, they will be given effect as between the parties themselves and all persons charged with notice, so that the intent of the parties may be carried out, and the whole agreement actually made, may be effectuated. The courts have usually held that this does not mean that the provisions of one instrument are imported bodily into another, contrary to the intent of the parties. They may be intended to be separate instruments, and to provide for entirely different things. Hence the provisions of a mortgage securing a contemporaneous note, which merely relate to the preservation of the security, are not as a rule construed as a part of the note so as to destroy its negotiability.

Thorpe v. Mindeman, 123 Wisc. 149; 101 N. W. 417.

So, also, where the provisions of a contemporaneous written instrument are contradictory and repugnant to the bill or note, it is usually held that they will not be construed together and that the provisions of the note control.

White v. Miller, 52 Minn., 367; 54 N. W. 736,
(3 R. C. L. par 54.)

In applying these rules, however, the courts are far from being in harmony. Conceding the general rule that a note may be rendered non-negotiable by reason of provisions in the mortgage executed and delivered with the note and as part of the same transaction and referred to in the note, it remains to be considered what particular provisions in a mortgage will so render the note non-negotiable. As a general rule, it may be stated that, when

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the note adopts the terms of the mortgage as a part of the contract and the terms of such mortgage are such as to make the note uncertain or conditional as to amount, the time of payment or the like, it makes the note non-negotiable.

Des Moines Savings Bank v. Arthur, 163 Iowa, 205
143 N. W. 556.
Garnett v Meyers, 65 Neb.280; 91 N. W. 400, 94
N. W. 803.

On the other hand, if the provision of the mortgage, even if actually incorporated in the note, would not affect its negotiability, the mortgage provisions have no effect on the negotiability of the note, except in California.

Farmer v. First National Bank 89 Ark. 132.
Hunter v. Clarke, 184 Ill. 158; 56 N. E. 297.
Des Moines Savings Bank v. Arthur, 163 Iowa, 205;
143 N. W. 556,
Cox v. Cayan, 117 Mich. 599; 76 N. W. 96,
Blumenthal v. Jassoy, 29 Minn. 177; 12 N. W. 517,
Bradbury v. Kinney, 63 Neb. 754; 89 N. W. 257,
Cunningham v. McDonald, 98 Texas, 316; 83 S. W. 372,
Thorpe v. Mindeman, 123 Wisc. 149; 101 N. W. 417.

Likewise if the mortgage merely provides for the doing of an act which it would be the duty of the party to perform independently of such provision, the negotiability of the note is not affected.

Wilson v. Campbell, 110 Mich., 580; 68 N. W. 278;
Bradbury v. Kinney, 63 Neb. 754; 89 N. W. 257.

Some courts take the extreme position that provisions contained in a contemporaneous mortgate which, if in corporated in the note would destroy its negotiability, do not affect such negotiability, as they relate wholly to the security rather than to the indebtedness. A more or less common provision in a mortgage in some states is one requiring the mortgagor, that is, the maker of the note, to pay all taxes levied on the land or the mortgage, or insurance, and sometimes providing that in default thereof, the whole

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

debt shall be payable at once. Such provisions contained in the mortgage are held to make the note non-negotiable in Kansas, Michigan, Montana, Nebraska and Utah. On the other hand, the contrary is held in Colorado, Illinois, Iowa, Oregon, Washington and Wisconsin. The latter decisions proceed on the theory that such provisions in a mortgage relate wholly to the mortgage security and not to the indebtedness. Likewise, on this theory it was held in Oklahoma prior to the adoption of the Negotiable Instruments Act that provisions in a mortgage for attorney's fees upon foreclosure did not affect the negotiability of the note, although it would have been otherwise if such provisions were incorporated in the note.

Farmers National Bank v. Mc Call, 25 Okla. 600;
106 Pac. 866; 26 L.R.A.(NS) 217 and Note.

From the above it may be seen that the decisions of the various courts are widely divergent in considering even the same matter and under the same state of facts. I have considered, therefore, that the only thorough method of investigating the subject is by an examination and review of the decisions of certain of the state courts.

RULE IN THE UNITED STATES COURTS

The general rule, accepted by the United States courts, is that the assignee for value before maturity of a negotiable note and the mortgage securing it, without notice of any equities in favor of the mortgagee, is unaffected by any equities to which the note would be subject in the hands of the mortgagee. Upon foreclosure no other or further defenses are allowed against the mortgage than would be allowed if the action were brought in a court of law upon the note.

National Livestock Bank v. First Nat. Bank, 203
U.S. 296 (affirming 15 Okla. 194; 75 Pac. 130)
Chicago Railway Equipment Co. v. Merchants
National Bank, 136 U. S. 268 - 283,
Sawyer v. Prickett, 19 Wall (U.S.) 146,
Swift v. Smith, 102 U. S. 442.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In the case of Carpenter v. Longan, 16 Wall. 271 (U.S.) the Supreme Court said:

"All the authorities agree that the debt is the principal thing and the mortgage an accessory. Equity puts the principal and accessory upon a footing of equality and gives to the assignee of the evidence of the debt the same rights in regard to both. The mortgage can have no separate existence. When the note is paid, the mortgage expires. When the amount due on the note is ascertained in the foreclosure proceedings, equity recognizes it as conclusive and decrees accordingly."

In the case of Smith v. Nelson Land & Cattle Co., 212 Fed. 56, the collateral mortgage contained a provision that in the event of certain contingencies, the whole sum for which the notes were given might be declared immediately due. It was held that such provision did not destroy the negotiability of the note.

In the case of Chicago Railway Equipment Company v. Merchants Bank, 136 U. S. 283, Justice Harlan, speaking for the Supreme Court, said:

"If the notes had been in the usual form of promissory notes, and the maker had given a mortgage back to the payee, the title would technically have been in the payee until they were paid. But they would, in such case, have been negotiable securities protected in the hands of bona fide holders for value against secret defenses, and their immunity from such defenses would have been communicated to the mortgage itself. In Kenicott v. Supervisors, 16 Wall. 452, 469, it was said that where a note secured by a mortgage is transferred to a bona fide holder for value before maturity, and a bill is filed to foreclose the mortgage, no other or further defenses are allowed against the mortgage than would be allowed were the action brought in a court of law upon the note."

In the United States courts it has been held that the mere fact that a note contains on its face a reference to collateral security for the payment thereof, as where a note contains a provision that is is secured by a lien on real estate or that is is secured by mortgage, does not destroy its negotiability.

De Haas v. Dibert 70 Fed. 227.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Where, however, the mortgage provides that upon a failure of the mortgagor to pay taxes, they may be paid by the mortgagee and shall be added to the amount of the note and be recoverable in a separate action on the note, it has been held in the United States courts that such provision renders the amount of the note uncertain and destroys its negotiability.

Farquar v. Fidelity Insurance Co. Fed. Cas. #4676
Howell v. Todd, Fed. Cas. #6786.

A clear distinction is made in the Federal decisions between notes secured by mortgages which merely state that they are so secured and notes secured by mortgages which in terms adopt or incorporate into the note the terms of the mortgage. Thus, in the case of Klots v. Manufacturers Commercial Co., 179 Fed. 813, the promissory note was in the usual form except that it concluded with the following words: "subject to the terms of the contract between maker and payee of October 25, 1905." The court in passing upon the note said:

> "We think that whenever the payment of a note is expressly made subject to the equities growing out of, and defenses based upon, an existing or contemporanecus agreement, a person taking such note holds it subject to such equity and defenses."

It would appear from the above that where a promissory note states that it is "subject to the terms of a certain mortgage (or deed of trust) of even date herewith" there can be no question that in the United States courts terms contained in the mortgage militating against negotiability will affect the note.

RULE IN CALIFORNIA.

It seems that in California when a note is secured by a contemporaneous mortgage, whether on real or personal property, both instruments having been executed as part of one transaction, the said note, whether negotiable in form or not, is non-negotiable in fact if taken with notice of the existence

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the mortgage. Thus, in California, if a promissory note merely states, "this note is secured by mortgage (or deed of trust) of even date herewith," any person taking the note takes it subject to notice of the existence of the mortgage, and, therefore, subject to any equities existing between the original mortgagor and mortgagee. In cases where the note makes no mention of the fact that it is secured by mortgage and it comes into the hands of an innocent purchaser for value before maturity and without notice of the fact that it is secured by mortgage, the question of whether the assignee takes it free of equities seems to be in doubt in California.

The leading case on the subject in question, is that of Meyer v. Weber, 133 Cal. 681, decided in 1901, before the adoption of the Negotiable Instruments Act in this state. The note upon which the action was brought was negotiable in form. It contained, however, the following provision.

"This note is secured by mortgage of even date herewith".

And the mortgage contained provisions which, in the then existing state of law, would, if incorporated in the note, have destroyed its negotiability.

The court stated as follows:

> "The only question presented is, whether the instrument in suit is a negotiable promissory note. The appellant contends that it is, and that it must be considered separate from and independent of the mortgage given to secure the same; that the clause, (this note is secured by mortgage of even date herewith,) may be disregarded as forming no part of the obligation to pay as specified in the note. But the mortgage was delivered at the same time as the note, relates to the same subject matter and they form, substantially, one transaction. They must therefore be taken and considered together. . An independent action on a promissory note secured by mortgage is prohibited in this state. There can be but one action for the recovery of any debt or the enforcement of any right secured by mortgage upon real estate or personal property, which action must be in accordance with the provisions of this chapter (C.C.P. 726) . . . .The assignment and transfer of the note and mortgage in question, therefore, was without prejudice to any set-off or other defense existing in favor of the defendants, the same as though there had been no assignment and the action had been brought by the company to whom they were given."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In the case of Smiley v. Watson, 23 Cal. App. 409-412, decided without reference to the provisions of the Negotiable Instruments Law, the note provided that if the interest was not paid quarterly when due, the whole sum of principal and interest should become immediately due and payable at the option of the holder of the note. The court decided that this provision of the note itself destroys its negotiability. This, of course, has been changed in California since the passage of the Negotiable Instruments Law. By way of dicta, however, the court said:

> "Appellants insist: 1. That there was no failure of consideration for the note and deed of trust; 2. Conceding such failure, the note was negotiable, acquired by defendant before maturity in good faith and for value, and hence not subject to the defense of want of consideration. . . . .
>
> "In support of the second propostion, that the note is negotiable, appellants insist that the giving of a mortgage to secure payment does not affect the negotiability of a note, citing the case of McDonald v. Randall, 139 Cal. 246, which holds that the giving of a mortgage to secure the payment of a negotiable promissory note does not affect its negotiability. This, however, is in direct conflict with the case of Meyer v. Weber, 133 Cal. 681; Briggs v. Crawford, 162 Cal. 129; and National Hardwood Co. v. Sherwood, 165 Cal. 1 . . . .
>
> "We are unable to distinguish a transaction where such a clause (maturing the note at the option of the holder upon default in payment of interest) is inserted in the note from one wherein it is omitted from the note, but inserted in the mortgage construed with and considered as a part of the note. If in the latter case it renders the note non-negotiable, its insertion in the note itself must for like reasons have like effect. The weight of authority elsewhere supports the contrary view, and we would be reluctant, by reason of the importance of the question as affecting the commercial interest, in following the doctrine announced in Meyer v. Weber, were it not for the fact that in the late case of National Hardwood Co. v. Sherwood, 165 Cal. 1, the Supreme Court, Sitting in banc, reiterated the doctrine and reasserted that such provision contained in a mortgage, but omitted from the note, is obnoxious to section 3088 of the Civil Code, and renders the note non-negotiable."

In the case of National Hardwood Co. v. Sherwood (Supra) the note apparently contained no terms which would destroy its negotiability. The

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

mortgage, however, provided that upon default in the payment of interest on the note, the holder should have the option to declare the whole sum due immediately. The note and mortgage having been executed prior to the adoption of the Negotiable Instruments Act in this state, it was construed under the rules then existing, without reference to that act. The court held that the fact that the note stated upon its face that it was secured by a mortgage, rendered it non-negotiable. The opinion is in part as follows:

> "It appears to be settled by the decisions of this court that where a note is secured by a mortgage on land, both being executed at the same times, or as parts of one transaction, the note, although negotiable in form, is not negotiable in law, where the purchaser takes it with knowledge of the existence of the mortgage . . . . It should be remarked, however, that in the present case and also in Meyer v. Weber and Briggs v. Crawford, the note recited that it was secured by mortgage. The result was that no person could receive the note as indorsee without notice of the fact that it was accompanied by the mortgage. <u>There is nothing in any of the decisions which would support the claim, should a case arise, that, in the absence of any such recital in the note, one who should purchase it for value before maturity, in good faith and without knowledge or notice of the mortgage, could not hold it as a negotiable instrument and free from any defense which the maker might have as against the payee or any previous holder.</u>"

In the case of Metropolis Trust & Savings Bank v. Monnier, 169 Cal. 595, the appellants sought to avoid the effect of the dicta in the case last quoted by calling to the attention of the court the fact that the note contained no reference to the mortgage and that the mortgage contained no covenants not permitted in a negotiable instrument. The court, however, refused to sustain the contention, saying:

> "The note and mortgage were made, executed and delivered simultaneously. All of the transfers involved in this litigation were of the note and mortgage. The plaintiff and first intervenor pray for relief based upon a covenant of the mortgage not contained in the note. So far as all of the parties to this litigation are concerned, the note and mortgage were known to be co-existent and interdependent. They were non-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

negotiable. To make them so it was not necessary that the note should state upon its face that it was coupled with a mortgage."

Thus it can be said that the courts of California have gone only to this extent; they have held, inferentially at least, that the only case in which a note secured by mortgage can be negotiable is that such note makes no reference to the mortgage and that it shall have come into the hands of an innocent purchaser for value before maturity and without notice of the fact that it was ever secured by mortgage.

Meyer v. Weber, 133 Cal. 681,
Briggs v. Crawford, 162 Cal. 125,
Helmer v. Parsons, 18 Cal. App. 451,
Mentry v. Broadway Bank, 20 Cal. App. 389,
Taylor v. Jones, 165 Cal. 108,
Fuller v. Blinn Lumber Co. 32 Cal. App. Dec. 574,
Stoner v. Security Trust Co. 32 Cal. App. Dec. 30.

It has also been held in California that a collateral contract executed at the same time as a promissory note and referred to in the note will, if the contract contains any terms affecting negotiability, destroy the negotiability of the note.

Byer v. Inter. Bank Corp. 262 Fed. 292-296.

" In the familiar application of the rule to notes secured by mortgages, frequently one of the instruments refers to the other. The rule is not changed when no such reference is made. In the hands of the original payee or of a transferee of the note with knowledge of the collateral agreement, whether or not the note is negotiable in form, it is non-negotiable in fact."

Spotten v. Dyer, 29 Cal. App. Dec. 503.

Doubt is expressed in some of the earlier California cases as to whether or not the provisions of a deed of trust will have the same effect as those of a mortgage in rendering the note non-negotiable. This doubt seems to have been resolved against the negotiability of such notes in the recent case of Quinn v. Rike, 33 Cal. App. Dec. 709 (Dec. 1920), wherein it is said:

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"In January 1916, the defendant executed and delivered to her co-defendant a promissory note, negotiable in form, in the sum of $2000.00. For the purpose of securing payment of the same she made and executed a deed of trust to a certain Title Insurance and Trust Company. The note was, therefore, non-negotiable."

In view of the unusual position taken by the courts of California, much difficulty was formerly encountered in this state in connection with the negotiability of bonds intended to circulate in the open market and secure which, underlying mortgages were given. In the case of Kohn v. Sacramento Electric, Gas & Railway Co., 168 Cal. 6, the court was called upon to pass upon the negotiability of certain bonds and interest coupons of the Sacramento Electric, Gas and Railway Company secured by a mortgage upon the real and personal property of the corporation. Indorsed upon each of the bonds was a certificate of the trustee to the effect that the bond was secured by a trust mortgage therein mentioned. An officer of the Trust Company in whose custody the bonds had been placed feloneously obtained a number of them and negotiated them to plaintiff who paid value therefor. The money paid by plaintiff for the bonds was not used for the benefit of the corporation. The bonds and coupons being payable to bearer, the purchaser contended that the corporation was not entitled to any defense to the payment thereof. The court decided that, although the bonds were payable to bearer and were intended to circulate without registration or indorsement, they were non-negotiable, saying:

"It is the contention of appellants that the bonds, being supported by a mortgage containing conditions not certain of fulfillment, and notice of the mortgage and its conditions appearing upon the bonds and coupons themselves, the bonds are not and cannot be negotiable instruments. In other words, appellants rely upon the rule announced in Meyer v. Weber, 133 Cal. 685 . . . . . that a note secured by a mortgage on land, both being executed at the same time as part of one transaction, is not negotiable in law, even if negotiable in form, where the purchaser takes it with

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

knowledge of the existence of the mortgage . . . . .
There is no essential difference between the two kinds of instruments and we see no escape from the logic of the position of appellants that a bond like a note, if dependent upon a mortgage, is subject to all equitable defenses against a holder with notice.. . . . .
There seems to be no good reason why bonds should be placed in a class governed by different principles than those applicable to notes."

In order to avoid the effect of this decision and to place bonds on a different footing from ordinary promissory notes secured by mortgages, the 1921 session of the California Legislature passed the following law:

"Bonds payable to bearer or holder shall be negotiable, notwithstanding any conditions contained therein or in the mortgage, deed of trust or other instrument securing the same."

(Chap. 344 Cal. Session Laws 1921; in effect July 29, 1921.)

Summarizing, it may be said, therefore, that all promissory notes secured by mortgages or deeds of trust on real or personal property in California are non-negotiable in the hands of a transferee, even though the transfer be made for value and before maturity of the note, provided the transferee takes with actual or constructive notice of the existence of the supporting mortgage. The only exception to this rule is that in reference to bonds payable to bearer or holder, referred to above.

RULE IN WASHINGTON

The rule in the State of Washington seems to be that if the note is negotiable upon its face, even though it refers to the fact that it is secured by a contemporaneous mortgage and even though the mortgage contains provisions which if incorporated in the note might render it non-negotiable, the note is negotiable. In so holding, it will be seen that the courts of the State of Washington have reached a conclusion in accordance with the general rule and exactly opposite to the conclusion reached by the courts of the State of California. This rule, however, only applies where the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

promissory note does not in terms adopt and incorporate as part of the contract the provisions of the mortgage. Where the promissory note contains such terms as "This note is subject to all the terms and conditions of a certain mortgage executed of even date herewith," or other similar terms, the note and mortgage are construed as one contract and any terms contained in the mortgage which, if contained in the note would affect its negotiability, will have a like effect and will destroy the negotiability of the note.

In the case of Barker v. Sartori, 66 Wash. 260; 119 Pac. 611, the notes were secured by mortgages which contained stipulations requiring the maker to pay, in addition to the principal debt and interest, such sums as the mortgagee might be required to incur for insurance, taxes and assessments on the land. It was argued that the mortgages should be construed with the notes and that the aforesaid provisions rendered the amount to be paid uncertain. The court stated:

> "It is apparent that the notes in this case were negotiable instruments. . . . . . The fact that the interest was payable in installments does not render the notes uncertain. . . .We are satisfied that the provisions of the mortgages were not imported into the notes, so as to render them non-negotiable." Citing
>
> Thorpe v. Mindemand, 123 Wisc. 149; 101 N. W. 417.
> Farmers Bank v. Mc Call, 25 Okla. 600; 116 Pac. 866
> American Savings Bank & Trust Co. v. Helgesen, 116 Pac. 837.

So also in the case of Bright v. Offield, 81 Wash. 442; 143 Pac. 159, the court, in passing upon negotiability of a note which referred to a mortgage securing it, said:

> "According to what we believe to be the better rule, a mortgage securing a note, though referred to in the note, but without expressly adopting its conditions, is merely ancillary to the note, and the conditions found in the mortgage alone will not change the character of the note as a negotiable instrument. The promise to pay is held to be a distinct agreement from the mortgage and if couched in proper terms, the note is negotiable."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

119

The same conclusion was reached in the cases of Lovell v. Musselman, 81 Wash. 476; 142 Pac. 1143, and Moore v. Burling, 93 Wash. 217; 160 Pac. 420, although by a slightly different process of reasoning.

Summarizing, it may, therefore, be said that in the State of Washington the only manner in which the negotiability of a promissory note, otherwise in proper form, can be destroyed is by placing in the note a reference to the mortgage adopting the terms of the mortgage as part of the note. Even in such event, it is my opinion that the negotiability of the note would not be destroyed unless the mortgage contained terms repugnant to the provisions of the Negotiable Instruments Act. In the State of Washington, subject to the foregoing exception, a purchaser of a promissory note negotiable in form for value and before maturity takes the note free from any equities existing between the mortgagor and mortgagee.

RULE IN OREGON

In Oregon the fact that a promissory note is secured by a chattel mortgage does not, of itself, affect the negotiability of the note. In those cases where the mortgage contains provisions which, if incorporated in the note would destroy the negotiability thereof, such provisions are not imported into the note and do not affect its negotiability unless incorporated therein by direct reference in the note to the mortgage and adoption of its terms.

In other words, the courts of the State of Oregon have followed the majority rule. In the case of Bailey v. Inland Empire Company, 75 Oregon, 309; 146 Pac. 991, the rule is stated in the following lanuage.

> "A mortgage, being merely an incident to the note which it secures, the assignment of the former cannot hamper or destroy the negotiability of the latter. No question is made about the note being negotiable on its face."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The same rule, however, applies in Oregon, which applies in practically all other jurisdictions; that is, that where the note expressly adopts the mortgage and states that it is subject to the terms and conditions thereof, all the terms of the mortgage are imported into the note and any of such terms which, if contained in the note would destroy negotiability, will have a like effect, though contained in the mortgage. Thus, in the case of Hull v. Angus, 60 Ore. 95, 118 Pac. 284, the note stated as follows:

> "This note is given as a part of the purchase price of real property and is secured by mortgage of even date herewith, and is subject to all the terms and conditions of said mortgage."

The court, in passing upon the negotiability of this note, said:

> "An instrument to be negotiable must contain, among other things, an unconditional promise or order to pay a sum certain in money. . . . . . It would be doing violence to the language to say that the note is unconditional, when it expressly says upon its face that it is subject to conditions. The reference to the mortgage by the terms of the note is in effect making the note and mortgage one instrument, with the conditions rendering the note non-negotiable."

This decision, as stated above, is merely in conformity with the general rule on this subject. The court in this case recognizes a contrary holding wherein it states:

> "There are, however, numerous decisions to the contrary. Many of the courts hold that the provisions of the mortgage do not affect the negotiability of the note, otherwise negotiable, because the provisions of the mortgage relate solely to the security."

The leading case in Oregon on the subject of the negotiability of promissory notes secured by mortgages is that of Page v. Ford, 65 Ore. 450; 131 Pac. 1013. The note in this case was given as part of the purchase price of certain real estate and personal property. On the margin of the note these words were written:

> "This note is secured by mortgage of even date given to secure the balance of the purchase price of the property described in said mortgage."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The mortgage, it seems, provided that the mortgagor should pay all taxes assessed upon the land covered thereby as well as all taxes that might thereafter be assessed on the note. The court, holding the note negotiable, stated as follows:

> "The third proposition raises the question as to whether the provision in the mortgage requiring the mortgagor to pay all taxes that might thereafter be assessed on the note renders the amount due thereon uncertain, and therefore non-negotiable. It is contended by respondent with much plausibility that the note and mortgage, having been given at one time and as part of the same transaction, should be construed together as one instrument. The logical effect of this argument would be to incorporate into the note, and into every other note executed simultaneously with and to secure a mortgage every stipulation of the mortgage. While this result does not seem to have been fully apprehended by courts holding the views hereinafter considered, it cannot be denied that the position of counsel for respondents has respectable authority to support it. . . . . The conclusions drawn in the cases noted seem to us to be supported neither by sound logic nor public policy. Their logical result is to make every promissory note secured by real estate mortgage a part of the mortgage, and subject to all its stipulations and conditions, thereby reducing it to a mere contract not negotiable. They assume that when parties sit down and execute a promissory note, negotiable by its terms, and secure it by a mortgage, they intended as a matter of law to do the thing that as a matter of fact they never thought of doing, namely, to make a non-negotiable note. As a matter of public policy, such holdings tend to discredit and cheapen commercial paper and to render purchasers thereof suspicious of investing in it when secured by mortgages, often held and recorded at a distance from the place where such paper is offered for sale. . . . . . . .It is hardly conceivable that it was the legislative intention to render notes so secured non-negotiable."

It may be said, therefore, that in Oregon all notes negotiable upon their face, remain negotiable even through secured by mortgage unless by the terms of the note, the mortgage and note are made one contract.

RULE IN IDAHO

In Idaho, as in California, a mortgagee may not waive his security and sue upon the note as an unsecured debt. Section 6949 of the Compiled Statutes of Idaho (1919), provides that but one action may be brought for the recovery of any debt or the enforcement of any right secured by mortgage

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

upon real estate or personal property, which action must be in accordance with the provisions of the chapter relative to foreclosure.

Cederhold v. Loofborrow (Ida. 1886) 9 Pac. 641,
Advance Thresher Co. v. Whiteside (Ida. 1891), 26 Pac. 660.

In the case of Barnes v. Buffalo Pitts Co. (Ida. 1899) 57 Pac. 267, the court holds that no money judgment can be rendered on debts secured by chattel mortgage until the security is exhausted, thus holding, at least inferentially, that the security cannot be waived. It would seem that if the holder of the note could waive the security afforded by the mortgage and sue on the note as through unsecured, the negotiability of the note must, of necessity, be determined from the provisions contained therein, without reference to the mortgage.

The effect of securing a promissory note by mortgage has not been specifically passed upon in the State of Idaho. In the case of Lewis v. Sutton (Ida. 1912) 122 Pac. 911, the court uses language which seems to lead to the conclusion that the note and mortgage will be construed together and that any terms contained in the mortgage destroying negotiability will be imported into the note. The court in this case says:

> "In a proceeding, therefore, to foreclose a mortgage securing promissory notes, the action is founded upon the notes and mortgage. The foreclosure proceeding is the one action that can be maintained, and the notes and mortgage are inseparably connected . . . . The notes themselves are merely evidences of the indebtedness, and the fact that the notes provide that if suit be brought upon them there shall be allowed a reasonable attorney's fee does not change or alter the conditions in the mortgage to the effect that the fee shall be a stipulated sum."

The court in the case of Clark v. Paddock, (Ida. 1913) 132 Pac. 795, also seems to hold that the note and mortgage are inseparable and, inferentially at least, that any terms contained in the mortgage which destroy negotiability will be construed with the note. As stated above, however, the question under discussion has not been specifically passed upon in Idaho and the law in that state is in a very unsatisfactory condition. On account of the similarity between the laws of Idaho and California relative to mortgages,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

I am inclined to the belief that the courts of Idaho will, when called upon, follow the rule laid down in California, and will hold that the note and mortgage are to be construed together as one contract, and that, where the holder of the note takes with notice of the fact that it is secured by mortgage, he takes it subject to all the terms and conditions of the mortgage.

Dighton v. First Exchange Nat. Bank (Ida. 1920) 192 Pac. 832.
Mullen v. Gooding Implement Co. (Ida. 1911) 113 Pac. 566,
Bank of Montpelier v. Montpelier Lumber Co. (Ida. 1909) 102 Pac. 685,
Rein v. Callaway (Ida. 1901) 65 Pac. 63.

RULE IN UTAH

The law in Utah relative to the subject under discussion is even less fully developed than in Idaho. As in Idaho the question as to whether or not the provisions of the mortgage or collateral agreement may render the note non-negotiable turns somewhat upon the consideration of whether one holding a note secured by mortgage may waive the security and sue upon the note. If the holder of the note and mortgage may waive the security, it is difficult to see how any provisions of the mortgage can affect the negotiability of the note.

Section 7230 of the Compiled Laws of Utah provides that there can be but one action for the recovery of any debt or the enforcement of any right secured by mortgage upon real estate or personal property, which action must be in accordance with the provisions of the law relative to foreclosure. The only exception to the above rule is that where the subject of the mortgage has ceased to exist or has become valueless, without the fault of the mortgagee, an action on the note, without foreclosure of the mortgage may be brought. In this respect the laws of Utah are similar to those of California.

The leading case in Utah on this subject is that of Donaldson v. Grant (Utah 1897), 49 Pac. 779. This case was decided before the adoption of the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

154

Negotiable Instruments Law in Utah. There is, however, nothing in the later decisions of the Supreme Court of the State of Utah to indicate that the rule laid down in that case has been changed. In the case referred to the note secured by the mortgage contained the following provision:

> "If default be made in the payment of any of theinterest after it becomes due or failure to comply with any of the conditions or agreements contained in the mortgage given herewith, then said principal sum, with the accrued interest thereon, shall,at the option of the holder of the note, become due and payable."

It was held that this provision rendered the note non-negotiable.

It is to be noted, however, that this case is not decisive of the question of what effect a mortgage merely referring to a promissory note which it secured would have upon the note.

The mortgage in the Donaldson case contained many terms which would destroy negotiability if contained in the note and in view of the fact that the note adopted all of the terms and conditions of the mortgage, the court could hardly have held otherwise. We are left without advice as to what the court would have held had this incorporating language been left out of the note itself. The Donaldson case has not been referred to again in the Utah decisions and is still the latest decision in that state upon the point of inquiry.

The case of Frost v. Fisher (Colo) 58 Pac. 872 Page v. Ford, supra, and Thrope v. Mindeman (Wisc.) 101 N. W. 417, referring to the case of Donaldson v. Grant, differentiate it from cases in which the note does not adopt the terms of the mortgage. While there seems to be a general tendency among all the courts to uphold the negotiability of notes which are plainly negotiable upon their face, irrespective of the terms contained in the collateral security, it is impossible, in view of the present lack of authoritative statement in Utah, to say what the courts of that state will determine as to the negotiability of notes secured by mortgages in which the note merely refers to character of the security.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

RULE IN ARIZONA AND NEVADA

In neither Arizona nor Nevada do we find any authoritative statement on the subject under discussion. This, however, is not surprising as the decisions of these two states are, as a whole, somewhat lacking in interpretations of substantive law. We do find certain decisions, however, which, while not in point, show the trend that the courts of these states have taken in regard to the negotiability of notes secured by mortgages.

In the case of Burling v. Goodman, 1 Nev. 314, the following significant language is used:

> "The quality or character of the contract is in no wise affected because the debt created thereby has been secured by mortgage. The security is merely an incident to the debt contracted and sought to be recovered."

The only other case found in the Nevada Reports which even remotely passes upon the matter is that of Dixon v. Miller, 43 Nev. 280; 184 Pac. 926. In this case, in a suit upon a promissory note secured by chattel mortgage a defense of failure of consideration was urged. The plaintiff, however, was the payee of the note, so that the question of the rights of a bona fide holder were not involved. The note in question was negotiable in form and merely referred to the fact that it was secured by chattel mortgage of even date. The court said:

> "Absence or failure of consideration is a matter of defense as against any person not a holder in due course. Appellant is not a holder in due course, but is the payee thereof and therefore under the statute the respondent is entitled to defend by impeaching the consideration of the instrument."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

It may be said from the above that the court intimated that if the note and mortgage had passed to a bona fide holder before maturity, it would have so passed free of any equities and immune from any defenses of failure of consideration. Thus it may be said that the courts in Nevada seem to differentiate between the contract entered into through the note and that entered into through /the mortgage and that a negotiable promissory note would pass to a bona fide holder, before maturity, free of any equities or defenses arising out of any matter contained in the mortgage. More than this cannot be said of the Nevada decisions.

In Arizona, while the matter has not been directly adjudicated, we find some more authoritative statements.

In the case of Newman v. Fidelity Savings & Loan Association, 14 Ariz. 354; 128 Pac. 53, an assignee of the mortgage failed to record the assignment to him of that instrument. The original mortgagee fraudulently released the mortgage he had assigned and the property being so cleared of encumbrance, was unencumbered by a new mortgage. The court held that the rights of the second mortgagee, accruing after the fraudulent releases, were superior to those of the original mortgagee, saying:

> "A negotiable note passes by indorsement, carrying with it the mortgage collateral thereto. A bona fide holder of a negotiable note before maturity takes it clear of all equities."

In the case of Slaughter v. Bank of Bisbee (Ariz. 1916) 154 Pac. 1040, the note was negotiable in form. It, however, contained a notation "for payment under contract of even date." Suit was brought by a purchaser before maturity and was resisted upon the ground that the contemporaneous contract referred to in the note had been broken. The court held the note to be negotiable upon the ground that the reference was merely one to the transaction from which the note arose and did not

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

subject the payment of the note to a contingency.

> "The usual way to condition or to make contingent a promise to pay is to use language clearly carrying that intention and purpose, either by direct expression or by reference to some extrinsic contract in such manner as to make the payment of the note subject to the terms and conditions of the contract."

This case leads to the conclusion that a reference in a note, otherwise negotiable, to the fact that it is secured by mortgage, would have no effect upon the negotiability of the note.

In the case of Edwards v. Dealers Ice Company (Ariz. 1915) 148 Pac. 908, the note referred to a certain chattel mortgage on personal property of even date given to secure the note. The question as to whether an alleged illegal provision in the chattel mortgage invalidated the note was raised and the court said:

> "The note is an independent contract from the contract of surety. The mortgage is only to secure the payment of the note, ... and the appellant contends that the chattel mortgage and the note it was intended to secure are void, because the note on its face refers to the chattel mortgage as securing it, and the chattel mortgage contains an illegal provision . . . . Here we have a note referring to another instrument made at the same time, alleged to contain an illegal condition. The note is clearly severable and separable from the chattel mortgage instrument . . . . . The note may be enforced and the mortgage containing the said provision may be disregarded."

From the above decisions, I am of the opinion that, when called upon to pass upon the matter, the courts of Arizona will hold:

1. That the mere fact that a note is secured by mortgage does not, of itself, affect the negotiability of the note;

2. That the note and mortgage even though executed simultaneously are separate instruments and that a reference in the note to the fact that it is secured by mortgage will not affect the negotiability of a

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

note otherwise negotiable; and

3. Even though the contemporaneous mortgage contains provisions which, if incorporated in the note would destroy its negotiability, the holder of the note is at liberty to disregard the mortgage security and sue upon the note as though it were unsecured; therefore, that terms destroying negotiability contained in the mortgage will not, unless incorporated in the note by appropriate terms contained therein, affect the negotiability of the note secured thereby, otherwise negotiable in form.

OTHER JURISDICTIONS

COLORADO

In the case of Frost v. Fisher, 13 Colo. App. 322; 58 Pac. 872, a mortgage given to secure a note, which was on its face negotiable, provided that, in case the mortgagor failed to pay the taxes on the property or the premiums of insurance thereon, the holder of the note might pay such taxes or premiums and the amount so paid would become an additional indebtedness secured by the same mortgage. The mortgage also provided that in case of sale, the mortgagee should apply the proceeds to the payment of the additional indebtedness and then to the payment of the note. It was held that the additional indebtedness was a distinct debt chargeable to the land alone and that it did not pertain to the note in such manner as to render the amount thereof uncertain and the note non-negotiable. The court said:

> "A mortgage may contain a personal covenant so expressed that the terms of the note would be modified and controlled by it. In such case, the covenant would be imported into the note and, in determining the obligation and liability of the maker,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

should be construed with the note as part of it. But we do not think that the rule applies to a covenant which is inserted purely for purposes of security and for the enforcement of which resort can be had only to the property mortgaged."

DISTRICT OF COLUMBIA

In the case of Brewer v. Slater, 18 App. (D.C.) 48, the court follows the majority rule, using the following language:

"It requires no citation of authority to show that a negotiable note secured by mortgage upon land loses none of its attributes by reason of that fact. The mortgage is an incident to the debt and passes with its assignment. The debt evidenced by the note gives character to the mortgage and protects it from equities between the mortgagor and the mortgagee in behalf of bona fide holders of the note for value. A mortgage, with or without power of sale, detracts nothing from the quality of the debt which it secures though it may add commercial value through its lien. That the note may recite or show upon its margin, which seems to be the general custom, that it is secured by mortgage or other lien, cannot affect the doctrine stated."

ILLINOIS.

The minority rule is followed in Illinois, where it is held that where resort is had by the holder to the mortgage security, the mortgage follows the note and that the note in the hands of assignee is subject to any defense which would avail against it in the hands of the mortgagee himself, although the assignee may have purchased the note in good faith for a valuable consideration and before maturity.

White v. Sutherland, 64 Ill. 181
Olds v. Cummings, 31 Ill. 188.

In the case last cited the rule is stated in the following language:

"The note itself, though secured by a mortgage is still commercial paper; and when the remedy is sought upon that, all the rights incident to commercial paper will be enforced in the courts of law. But when the remedy is sought through the medium of the mortgage,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

when that is the foundation of the suit and the note is merely used as an incident, then courts of equity must look deeper in the transaction and see if there be any equitable reason why it should not be enforced."

This case is a leading authority in Illinois on the subject and has been followed in the following cases:

Couton v. Cameron, 205 Ill. 50; 87 N. E. 800, Romberg v. McCormick, 194 Ill. 205; 62 N.E. 537, Chicago Title Co. v. Alff, 183 Ill. 91; 55 N.E. 659; Buehler v. McCormick, 169 Ill. 269; 48 N.E. 287, McAuliffe v. Reuter, 166 Ill. 491; 46 N.E. 1087.

It should be said that the courts of Illinois have often shown dissatisfaction with the rule as established in the case of Olds. v. Cummings and have on occasions sought to restrict rather than extend it. Thus, the rule has been held not applicable to an assignee or holder of accommodation paper secured by mortgage.

Miller v. Larned, 103 Ill. 562.

And the courts have refused to extend the rule to deeds of trust given to secure railroad coupon bonds intended to be thrown on the market and circulated as commercial paper.

Peoria Railroad Co. v. Thompson, 103 Ill. 187.

IOWA

In Iowa it has been held that a stipulation on the back of a note that it was secured by mortgage and that the payee agreed to look to the mortgage security for the payment of the note, became part of the note and rendered the note non-negotiable.

Allison v. Hollenbeack, 138 Iowa, 479; 114 N.W. 1059.

This decision, however, is merely in conformity with the general rule that where the note adopts or incorporates into it the terms of the mortgage, its negotiability will be controlled by such terms.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The courts of Iowa, however, in one case at least, seem to have adopted the minority rule to the effect that the negotiability of the note may be destroyed by terms contained in the mortgage executed simultaneously with the note even though the holder of the note may have had no notice of the mortgage at the time he accepted the note.

In the case of Iowa National Bank v. Carter, 144 Iowa, 715, 123 N. W. 237, the notes were secured by chattel mortgage executed as part of the transaction. The mortgage provided that the whole debt should become due in case of the sale or removal of the property by the mortgagor with the consent of the mortgagee or in case the latter deemed himself insecure. The court said:

> "We are satisfied that by reason of recitals in the mortgage, not only the time of payment, but the amount thereof, was uncertain and subject to a contingency, and that the notes were non-negotiable, and are subject to the defenses pleaded in the hands of the holder, although he may have had no knowledge or notice thereof when he took the notes."

This case was decided under the provisions of the Negotiable Instruments Law.

An opposite position seems to have been assumed by the Iowa courts in the later case of DesMoines Savings Bank v. Arthur, 163 Iowa, 205; 143 N. W. 556. The note in this case provided:

> "This note is secured by a mortgage on 101 acres of land in Madison County, Iowa."

The court, in holding the note to be negotiable, stated as follows:

> "The purpose of the mortgage was to afford security for the payment of the note, and all the conditions except one relate to the protection and preservation of the security. These have no bearing on the engagements contained in the note. While the note and mortgage are to be construed together, this does not mean that the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

provisions of the mortgage are thereby incorporated into and became a part of the note . . . As the provisions in the mortgage did not render the amount payable on the note uncertain, the note cannot be denounced as non-negotiable on this ground. Nor did the clause giving the mortgagee on breach of certain conditions, the election to declare the entire indebtedness due. . . . . Decisions to the contrary may be found on both of the foregoing propositions, but our conclusion has the support of the great weight of authority."

It is to be noted, however, that in Iowa there was at the time this decision was rendered, a statute (section 3428, Civil Code) by virtue of which a separate action would have been maintained on the note independently of the mortgage.

KANSAS

The courts of Kansas have repeatedly held that the note and mortgage are one transaction, constituting one contract and must be construed together as if they were parts of one instrument. They have also held that any terms in the mortgage which, if included in the note would destroy its negotiability, will have the same effect though incorporated in the mortgage.

Cabbel v. Knote, 2 Kans. App. 68; 43 Pac. 309,
Chick v. Willetts, 2 Kans. 379.
Muzzy v. Knight, 8 Kans., 306.
Meyer v. Graeber, 19 Kans. 166.

The general rule that where a note otherwise negotiable in form refers to the mortgage by which it is secured and incorporates the mortgage as part of the contract, the negotiability of the note will be affected by the terms of the mortgage has also been followed in Kansas.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Chapman v. Steiner, 5 Kans. App. 326; 48 Pac. 607,
Wistrand v. Parker, 7 Kans. App. 562; 52 Pac. 59
Jones v. Dulick (Kans App) 55 Pac. 522.
Wright v. Shimeck, 8 Kans App. 350; 55 Pac. 464.

MICHIGAN

The two leading cases on the subject in Michigan are those of Brooke v. Struthers, 110 Mich. 562; 68 N.W. 272; 35 L.R.A. 536, and Wilson v. Campbell, 110 Mich., 530; 35 L.R.A. 544. These two decisions, apparently without any distinguishing characteristics, decided by the same court, at the same term, seem to be in direct conflict. The note in the case of Brooke v. Struthers, contained the following provision:

> "This note is of even date with a certain real estate mortgage made by the maker hereof to the payee and collateral hereto."

The mortgage by its terms, required the mortgagor to pay all taxes and assessments upon the property. The court in holding the note non-negotiable said: (p. 575)

> "In the present case, the mortgage binds the mortgagor to pay all taxes and assessments upon the premises. Now if this might be said to be a provision to protect the security and therefore not affecting the note, yet when it provides in addition that when the mortgagor shall leave any tax or assessment, valid or invalid, unpaid for thirty days, that such taxes and assessments, whether previously paid by the mortgagee or not, and the whole amount of principal and interest shall become due and payable immediately, it injects into the obligation a contract, as much as though the maturity and amount of the obligation were to depend upon any other act or service agreed upon, calculated to enhance or maintain the value of the security. . . . . . A mortgage executed simultaneously with the note is a part of the contract and they are to be construed together . . . . . And where the note is secured by a mortgage, and there is a provision in the mortgage contained not contained in the note, it will control . . . . Several cases have

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

been cited to the proposition that 'when a note secured by mortgage is transferred to a bona fide holder for value before maturity and a bill is filed to foreclose the mortgage, no other or further defenses are allowed against the mortgage than would be allowed were the action brought in a court of law upon the note.' But this proposition does not militate against the contention that the note and mortgage are to be construed together, for a court of law would be bound to notice and apply the rule, and equity might do the same. We have been unable to find any case which holds or implies that the negotiability of a note will not be taken away by provisions which affect the certainties requisite to negotiable paper contained in a contemporaneous mortgage to which the note refers. We do, however, find cases which hold that a mortgage partakes of the negotiable character of the note so long as the provisions of the mortgage are not inconsistent with negotiability . . . . . . By reason of the provision which renders the note uncertain in time of payment and which ingrafted upon it certain contract obligations, the note was rendered non-negotiable unless, as already said, the holders of these notes are to enjoy immunity because of some peculiar sanctity arising from the fact that the mortgáge not the note contains the stipulation."

The case of Wilson v. Campbell, supra. was decided upon almost identical facts. The mortgage, securing the note, provided that the mortgagor should pay all taxes levied upon the property and that upon thirty days failure so to do, after the same became due, the note should become immediately payable. The only difference between this case and the Brooke case was that the mortgage did not provide that the unpaid assessments should be added to and become a part of the indebtedness. The court held that the provision for the payment of taxes, being a burden resting in any event upon the mortgagor, did not destroy the negotiability of the note. The line of demarkation between the two cases is, to say the least, very difficult to find.

MISSOURI

It has been held in Missouri that a note and deed of trust, executed simultaneously, constituted one transaction and that one

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

taking them with notice of the terms of the deed of trust takes it subject to all of the provisions of such terms.

Brownlee v. Arnold, 60 Mo. 79,
Naples v. Jones, 62 Mo. 443,
Noell v. Gaines, 68 Mo. 649.

These decisions, however, were expressly overruled in the case of Owings v. McKenzie, 133 Mo. 323.

In the case of City National Bank v. Goodloe, 93 Mo. App. 123-136, the court says:

"The defendant further contends that the note and mortgage must be construed together as one instrument and that the conditions set forth in the latter render the former non-negotiable. But this contention we are unable to concede to defendant . . . . . . The law now prevailing in this state is to the effect that a mortgage is a mere security creating a lien upon the property. The debt secured by the mortgage is the principal thing and the mortgage a mere incident, following the debt wherever it goes and deriving its character from the instrument which evidences the debt."

The rule has been affirmed by the Federal court interpreting the Missouri statute in the case of Kennedy v. Broderick, 216 Fed. 137, wherein the doctrine in this state is well set forth in the following language:

"If two instruments are executed at the same time, in the course of the same transaction, and covering the same subject matter, they are to be read and construed together as one instrument. But this doctrine does not apply to a transaction in which two separate and distinct matters are involved. Each is to be construed and interpreted as a complete entity, whether they be written in one paper or several.

"An unconditional promise to pay a certain sum at a certain time is a matter apart from security by way of deed of trust or mortgage of land or pledge or mortgage of chattels. One is governed by the law merchant and the other by property laws. The owner

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

> may rely if he chooses, exclusively upon the promise to pay according to its terms. Conditions for his benefit in the mortgage or pledge agreement may be availed of only in his capacity of mortgagee or pledgee. They are limited to the purposes of the mortgage or pledge. They can not be read into the promise to pay, and so render a certain promise uncertain or convert a negotiable instrument into a non-negotiable instrument."

The same doctrine is affirmed in the case of Goodfellow v. Stillwell, 73 Mo. 17. In this case the plaintiff purchased before maturity a negotiable promissory note secured by a deed of trust. Payment had, in fact, been made to the trustee on account of the note before it passed to the transferee. It was held, however, that the transferee having no knowledge of the payments was not bound by them and took the payment free from any equities existing between the maker and the trustee.

MONTANA

In Montana the same law exists as that in California; that is, that but one action can be brought for the recovery of a debt or the enforcement of a right secured by mortgage, which action must be in foreclosure.

The Montana courts seem also to have followed the California decisions in holding that a reference in a note to the fact that it is secured by mortgage will render the note non-negotiable if the mortgage contains any terms rendering the amount or medium of payment uncertain. The leading case in this state (and one which has been much criticized by the courts of other states as being bad law) is Cornish v. Woolverton, 32 Mont. 456; 81 Pac. 4.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The note in this case merely refers to the fact that it was secured by mortgage of even date. Both the note and mortgage were assigned, prior to maturity, to a purchaser for value and the assignment was recorded. The makers of the note defended, upon the ground that the indebtedness had been paid to the original mortgagee prior to notice of the assignment. The court after reviewing the conflicting decisions upon the question said:

> "For another reason it (the note) is non-negotiable. It refers on its face to the mortgage. Section 2207 of the Civil Code provides: 'Several contracts relating to the same matters, between the same parties and made as parts of substantially one transaction are to be taken together.' Under the rule of construction here declared, the conditions and stipulations embodied in the one must be construed to enter into and constitute a part of the other, so that, if the mortgage referred to in the note contains conditions which render the note uncertain as to the amount to be paid and the time of payment, these must be read into the note. The two must be read and construed together to ascertain the nature of the agreement upon which the negotiable character of the note depends. The reference to the mortgage brings to the notice of every one dealing with the note all the conditions attached, so that, even though it should be held negotiable so far as concerns the conditions expressed upon its face, its negotiable character must be determined by the provisions of the mortgage. This section of the statute sets at rest any question which might otherwise exist as to the rule of construction applicable. (Citing Meyer v. Weber, 133 Cal. 681).
>
> "Apart from the statute, there is a conflict in the decisions; the courts of some states applying the rule declared by the statute, but others holding that the conditions contained in the mortgage do not affect the character of the note secured thereby. In this state the mortgage is but an incident, and passes to the assignee of the note. This, however, does not affect the application of the rule, for it is the general rule in this country that a mortgage does not convey the legal title but is a mere lien to secure the performance

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the contract to which it is an incident . . . . The mortgage in this case contains a number of conditions, among them that the mortgagor will pay all taxes imposed upon the mortgaged property or against the holder of the mortgage . . . . Construing this condition as a part of the note, it is clearly non-negotiable . . . . The contention is also made by the appellants that a note, though negotiable in form, if secured by mortgage, is not negotiable in this state, even though it contains no reference to the mortgage, and without regard to any conditions contained in the latter. Inasmuch as the question involved is one of importance, we prefer to reserve a decision of it until a case arises in which we may have the advantage of full argument."

The latter question referred to in the above decision and upon which the court did not pass in that case seems to have been decided against the negotiability of the note when the note, though not referring to the mortgage, comes into the hands of the transferee with knowledge of the existence of the mortgage, in the case of Buhler v. Loftus, 53 Mont. 546; 165 Pac. 601.

This case was decided in 1917 and after the adoption in Montana of the Negotiable Instruments Law. This was an action brought by A. J. Buhler, the maker of the note and mortgage, against John H. Loftus and other transferees. The court said:

"The note did not refer to the mortgage and upon its face was negotiable. If it had been transferred by indorsement, without mention of the mortgage, what rights would have been acquired would have depended upon the solution of a different question from that before us . . . The transfer, however, was made by written assignment of the note and mortgage both. John H. Loftus, therefore, took it with full knowledge that it was a mortgage note, collectible by him only as such. It therefore did not come into his hands as a 'courier without luggage' but as a non-negotiable instrument subject to all the equities

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

existing in favor of J. M. Buhler at the time he received it. This was expressly so held by this court in Cornish v. Woolverton and that case is conclusive of this."

It may, therefore, be said that in Montana one who takes a note, even before maturity, and for value, with knowledge of the fact that the note is secured by mortgage, accepts it subject to all the terms and conditions of the mortgage which, if repugnant to negotiability, will destroy the negotiability of the note.

NEBRASKA

The leading case on the subject in Nebraska is that of Garnett v. Meyers, 65 Neb. 280-289; 91 N. W. 400; 94 N. W. 803.

The court in that case adopted the rule that if agreements in regard to the indebtedness are inserted in the accompanying mortgage executed as part of the same transaction, they must be construed with the note. If such agreements render the amount that the holder of the note can demand on the indebtedness itself uncertain, the note is non-negotiable in the hands of one who takes it with notice. The court said:

"The reasonableness of this rule would probably not be doubted in case the accompanying paper was not a mortgage, but was executed for the sole purpose of modifying the terms of the note or to make its payment dependent upon conditions expressed in the accompanying paper. The reason seems to be equally apparent when modifications of the terms of the note or limitations imposed upon the collection of the indebtedness itself are inserted in the accompanying mortgage. Such provisions in the mortgage are to be construed with the note. If the contract, so construed, renders the amount that may be determined upon the indebtedness itself uncertain, the one who takes the note with notice of the limitations in the mortgage is not entitled to protection as an innocent holder . . . . . .

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

It is well settled in this state, that although a note is absolute in form, every provision affecting the same or the amount or manner of payment, that is the contract in regard to the indebtedness itself, contained in the mortgage given to secure it, made contemporaneously, affects the note in precisely the same manner and to the same extent as though included with it on the same piece of paper, as to all persons chargeable with notice."

The case of Roblee v. Stockyards National Bank (1903) 95 N. W. 61, lays down the rule that a note otherwise negotiable is not rendered non-negotiable merely by a provision for or reference to collateral security; but that when the note and mortgage are executed together they must be construed together and any terms in the mortgage repugnant to negotiability will have a like effect upon the note. A similar conclusion was reached in the case of Conserdine v. Moore, 65 Neb. 291; 91 N. W. 399, in which case the court refused to uphold the contention that the provisions in the mortgage related merely to the preservation of the security and did not affect the negotiability of the note.

No very recent decisions upon this subject in Nebraska were found. It may be said that the rule in that state, as indicated by the above authorities, is that one who takes a note secured by mortgage with notice of that fact is chargeable with all the conditions of the mortgage and that the two being construed together, the negotiability of the note will be regulated by the provisions of the mortgage.

OKLAHOMA

It has been held in Oklahoma that a provision for attorney's fees in case of foreclosure incorporated in the mortgage does not affect the negotiability of the accompanying note although such provision, if incorporated in the note, would destroy its negotiability.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Farmers National Bank v. McCall (Okla. 1910)
106 Pac. 866.

This decision was rendered before the adoption in the State of Oklahoma of the Negotiable Instruments Act. The court, reviewing the conflicting decisions on the question said:

"In the case at bar, the note on its face is negotiable, but it is insisted that the mortgage securing payment of same provides for an attorney's fee in the event of foreclosure and that such provision also shall be construed as included in the note, thereby rendering it non-negotiable. There is a conflict of authority on this question. The great weight seems, however, to be against the contention and supporting the rule that a covenant in a mortgage which is framed purely for the purpose of security and for enforcement of which resort could be had only to the property mortgaged and not a part of any debt by virtue of the note, but on account of the terms of the mortgage, the terms and conditions thereof being limited to providing security for the indebtedness, does not affect the negotiability of the note . . . . . However, when the provisions of the mortgage by direct stipulation in the note are made a part thereof, the same in that event may be rendered non-negotiable.

"It is further insisted, however, that section 793 of the Code which provides 'Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together,' concludes this question in favor of the defendant in error.

"This section was borrowed by the lawmakers of the territory of Oklahoma from the statutes of Dakota territory. In the case of First National Bank v. Flath, 10 N. D. 281; 86 N. W. 867, this section was construed and held to constitute a rule of interpretation merely and united several contracts into a single contract only for such purposes, and that a real estate mortgage and the notes secured thereby did not constitute a single contract, but remained as separate contracts, except for the purposes of interpretation. We necessarily conclude that the stipulation in the mortgage regarding attorney's fees does not render the note non-negotiable."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

This decision has been followed in the later case of Westlake v. Cooper (Okla. 1918) 171 Pac. 859, in which it is pointed out that the holder of the note may abandon the mortgage entirely and recover on the note as though it were unsecured, in which event the terms of the mortgage would be immaterial.

It may be said, therefore, that the majority rule is followed in Oklahoma, and that unless a note expressly incorporates and adopts as part of the contract the terms of the mortgage, such terms will not affect the negotiability of the note.

TEXAS

The general rule that one who purchases before maturity for value a negotiable note secured by a mortgage, takes the paper free from equitable interests of third parties of which the holder has no notice is followed in case of Van Bukelo v. Southwest Manufacturing Company (Texas) 39 S. W. 1085.

In the case of Cunningham v. McDonald, 98 Tex. 316, 83 S. W. 372, it is held that a reservation in a deed of trust securing a note, of the right on the part of payor to make payments thereon at certain times prior to maturity does not destroy the negotiability of the note. While the point is not expressly decided, it is intimated in this case that the terms of a mortgage or deed of trust executed contemporaneously with the note and referred to therein will be examined in passing upon the negotiability of the note and that such terms may affect the negotiability of the accompanying note.

See also; Rogers v. Broadnax, 24 Tex. 538;
27 Texas, 238.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Thus, in the case of Robertson v. Parrish (Texas) C. A. 1897) 39 S. W. 646, it is held that the terms of a deed of trust, executed by a purchaser to secure his purchase of money note more than a month after giving the note and receiving the deed, became part of the contract of sale, and that the additional provisions of the deed of trust became part of the obligation.

> "This deed of trust provides that the note becomes enforceable by sale or suit if any of the interest remains unpaid for six months after due. This provision thus became ingrafted on the note."

> See also: Traders Nat. Bank v. Smith, (Tex. C.A.) 22 S. W. 1036.

Therefore, while no decisions directly in point have been found, it is believed that the courts of that state will construe contemporaneous instruments as one contract. Whether the courts of Texas will go to the extent of holding that the terms of a contemporaneous mortgage will be read into the note in the hands of a bona fide purchaser for value at maturity, who also takes the mortgage as security or who takes the note with knowledge of the existence of the mortgage, I am unable to say.

WISCONSIN

In the case of Thorpe v. Mindeman, 123 Wisc. 149; 68 L.R. A. 146, decided under the Negotiable Instruments Law, the Supreme Court of Wisconsin held that agreements in a mortgage by which the mortgagor is required to pay taxes, exhibit receipts and maintain insurance on the buildings for the mortgagee's benefit, and the mortgagee is given

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the privilege of effecting such insurance and having a lien for the amount so paid added to the indebtedness, not being intended to qualify the absolute promise in the mortgage note, does not change the note or affect its negotiability.

The court in this case reaches this conclusion by stating that the provisions for the payment of insurance are merely for the preservation of the security and do not affect the indebtedness itself. In other words, this court follows the majority rule:

> "Construing together simply means that if there be any provisions in one instrument limiting, explaining, or otherwise affecting the provisions of another, they will be given effect as between the parties themselves, and all parties charged with notice, so that the intent of the parties may be carried out, and that the whole agreement actually made may be effectuated . . . . . . The promise to pay is one distinct agreement and, if couched in proper terms, is negotiable. The pledge to secure that promise is another distinct agreement which ordinarily is not intended to affect in the least the promise to pay, but only to give a remedy for failure to carry out the promise to pay. The holder of the note may discard the mortgage entirely and sue and recover on his note; and the fact that the mortgage has been given with the note, containing all manner of agreements relating simply to the preservation of the security would cut no figure."

CONCLUSION:

It may be seen from the foregoing that the courts of the various states are in hopeless conflict on the question involved.

No attempt has been made to review the decisions of other states not mentioned, it being my opinion that on account of the wide variance in the decisions and processes of reasoning

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

by which the conclusions are reached, that it is necessary to examine the latest decision in the state in question in order to arrive at a safe conclusion as to the effect in such jurisdiction which mortgage security has upon the negotiability of the accompanying note.

(Signed) Albert C. Agnew,
Attorney.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis