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Consumer Protection—The Holder-In-Due-Course Defense In Consumer Sales

Many commercially-naive buyers in this state have been subjected to a consumer hoax of significant proportions. The mode of operation varies slightly with the type of product sold, but the consumer contact generally is initiated by salesman who, through various misrepresentations, pursuades the consumer to contract for a product worth only a fraction of its cost. Often the contract is evidenced by the execution of a promissory note and some type of security instrument. Within a short time, the seller assigns the indebtedness to a financial institution with which he has a prior agreement or some continuing business relationship. Often the financial arrangements with this type of transaction can be better characterized as an indirect loan between the financing agency and the buyer, with the seller merely procuring the loan for the financier. If the defrauded buyer decides to withhold payment the

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2 A common example is the home remodeling scheme. A salesman presents himself at the door of a low-income person who owns his own home and lot (which are generally valued in the neighborhood of $500 to $3500). He asks the homeowner if he needs his debts consolidated and/or what improvement he needs to his home. After securing an answer, the salesman informs him that he can get his bills paid as well as getting the home improvement (generally siding, a roof, or a bathroom), and his payments will be lower than at present, and perhaps for a shorter period of time. The salesman then requests the consumer's signature on papers—supposedly "credit applications" necessary to secure the loan. These "credit applications" are later found to be a blank sales contract, a blank deed of trust, and a blank promissory note. (Often the individual will know that he signed a contract, but seldom is he aware of a security interest taken in his property.) A few days later, two or three laborers perform a small amount of shoddy, incomplete work and then leave. The ratio of cost to value received is often as high as eight to one. Other well-known examples include the sale of home appliances, magazine subscriptions, hearing aids, chinchillas, and home furnishings.

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5 Normally, the financial institutions do business with a limited number of sellers. When financing agencies enter into either a written agreement or merely a verbal understanding with a seller to purchase obligations at a specific discount rate, generally the financer furnishes interest rate tables, mandates certain contractual provisions and provides form instruments that the seller is to use in his transactions.

6 In this indirect financing arrangement, the seller initiates contact with the buyer, who promises to pay the purchase price in installments to the seller. But prior to consumer contact, the financial institution has supplied the seller with printed forms (e.g., promissory notes, contracts, credit applications, security instruments, and completion certificates), and prescribed a procedure for the seller to follow in credit sales. (In the home improvement industry, the seller is directed to secure the buyer's signature to a credit application and an installment note at the time of the execution of the contract.}
financial institution brings suit on the note, claiming to be a holder in due course as to any defenses asserted by the buyer. Or perhaps, the buyer consults with a lawyer who explains to him why his defenses are most likely unassertable against the assignee of the indebtedness. In either event, the consumer must then pay the note, and is often unable to secure recovery against the original seller because he cannot be found or is judgment-proof, or because the buyer is unable to secure the services of an attorney in light of the minimal recovery generated in such cases. This note proposes to examine the legal theories which may be invoked by consumers attempting to prevail against a financing agency allegation of good-faith purchase.

The plight of the consumer in such situations is causing significant alterations in the concept of the holder in due course as it relates to the financing of consumer sales transactions. The inequities resulting from the application of the good-faith purchase concept to situations involving close business relationships between the seller and the financier have been recognized by writers

The credit application is forwarded to the financing agency which approves the loan. Upon completion of the work, the seller presents a completion certificate, the buyer's name often being affixed by the seller, and the note is then negotiated to the financial institution. This whole arrangement is described as an indirect loan because the financing agency has effectively made a loan of money to the buyer, the loaned money going directly to the seller for the product or home improvement, with the buyer repaying the financier directly in installments.

5 See UNIFORM COMMERCIAL CODE § 3-306; W. VA. CODE ch. 46, art. 3, § 306 (Michie 1966).

6 Of the many consumers who are defrauded, the few who seek legal advice are able to obtain little service from the legal profession. The attorney, faced with the difficulties of proof when dealing with a firm claiming the status of a bona fide purchaser, often negotiates a settlement with the financial institution whereby a small proportion of the cost is knocked off in return for a promise not to sue. The original price was so excessive and the discount rate to the finance company so large that it can easily absorb a small cut in its profit in the minimal number of obligations it has to reduce. The result is the consumer has to pay an unconscionable amount to the finance company, which continues to pursue its lucrative scheme with the seller.

and judges. Several jurisdictions have recently ameliorated the problem by legislative prohibition or by severe restriction of the negotiation of consumer sales paper. In an attempt to avoid injustice to the consumer, many courts have refused to grant preferred positions to financial institutions. But in refusing to grant protected status to purchasers of consumer sales paper in cases involving a close seller-financing agency relationship, the legal theories applied by the courts have been varied and unpredictable. The West Virginia Supreme Court of Appeals in deciding good-faith purchaser issues, has generally invoked the terminology of the statute in a conclusionary manner without prescribing an explicit, comprehensive rule to apply to all actual situations. Though some courts have designed common law rules, ample authority exists in West Virginia to permit a strong judicial pronouncement which could significantly limit this systematic consumer deception.

A. The Pre-U.C.C. Approach

The question of good-faith purchase of commercial paper had common law origins. A clear bifurcation of authority as to whether there was a duty to make inquiry prior to purchase arose in the early eighteenth century. Some courts require that the purchaser’s actual knowledge of a defense of the maker must be shown to de-
feat one asserting the status of a holder in due course. This is known as the subjective test. The objective test requires that the purchaser must use the means of an ordinary prudent man to ascertain the manner in which the instrument was obtained. The N.I.L., being generally a restatement of basic common law, did not alter this subjective-objective differentiation. Lack of, or inadequate definition of terms permitted the continuation of jurisdictional variations as to what facts were sufficient to deny one the status of a good-faith purchaser. Notice was defined as the purchaser's “actual knowledge of the infirmity” or his “knowledge of such facts that his action in taking the instrument amounted to bad faith.”

Though the initial portion of this “notice” definition clearly indicates a subjective test, the latter provision contemplates judicial construction. Each court, in deciding what “facts” were sufficient to constitute bad faith, made its own determination as to where its test fell in the subjective-objective dichotomy. This definition of notice, partially in terms of bad faith, and the lack of statutory definition of good faith led courts to consider the pre-conditions of lack of notice and good faith as a single requirement, using the terms almost interchangeably. The unitary treatment of these prerequisites has been followed by the West Virginia Court.

(B. & C. 1824), which mandated that the jury must consider whether the purchaser acquired the paper under circumstances which ought to have made a prudent man suspicious. For a discussion of the common law development of the bifurcated law of good faith, see Littlefield, Good Faith Purchase of Consumer Paper: The Failure of the Subjective Test, 39 S. CAL. L. REV. 48, 50-52 (1966).

3What are the “facts” which are sufficient to fall within the meaning of this section? This is a question that can only be decided on a case-by-case basis. See notes 100-07, infra, and accompanying text for general authority; notes 71-78 infra, for West Virginia authority.

4For example, one court can declare that a showing that the financers name appeared on the instruments is not sufficient “facts” to warrant imputing knowledge within the meaning of the definition. E.g., Implement Credit Corp. v. Elsingem, 268 Wis. 143, 66 N.W.2d 657 (1954); another will find that the same circumstance (finance company's name on forms) warrants an imputation of notice. E.g., Commercial Credit Co. v. Childs, 199 Ark. 1073, 139 S.W.2d 260 (1940).


14 A purchaser in good faith should be one who has purchased with due regards to the rights of the maker, and not one who, relying on paying value for the note and purchasing before maturity without knowledge of any defense, is indifferent as to whether the same was honestly obtained from the maker.” Id. at 649, 136 S.E. at 201; Marion Nat'l Bank v. Hardin, 83 W. Va. 119, 97 S.E. 600 (1918). In discussing the good faith prerequisite, the Court spoke of “knowledge of facts sufficient to put a prudent man on inquiry without actual knowledge” and circumstances “so cogent and obvious that to remain passive would amount to bad faith.” Id. at 124-25, 97 S.E. at 602.
The basic consideration of what "facts" are requisite to deny preferred status to a purchaser of commercial paper pursuant to the N.I.L. has led courts to formulate certain "tests" to apply to varying factual situations. Many courts specify that certain facts denote a "close connection" between the seller and the finance company which in itself deprives the purchaser of good faith status. Other courts have found that this close financer-seller relationship is sufficient to warrant denoting the financer the "original party" or a "co-participant" in the transaction. Still other courts declare that this close business relationship makes the financer the seller's principal within the meaning of common law principles of agency. Another approach is merely to impute notice or lack of good faith from certain minimal facts. The significance of these legal formulae rests in their focus on the basic issue — the nature and extent of the relationship between the seller and the financial institution.

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21 The often-cited case of Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W.2d 260 (1940), contains the basic formulation of this concept:

We think appellant [the financer] was so closely connected with the entire transaction or with the deal that it cannot be heard to say that it, in good faith, was an innocent purchaser of the instrument for value before maturity. It financed the deal, prepared the instrument, and on the day it was executed took an assignment of it . . . . Rather than being a purchaser of the instrument after its execution it was to all intents and purposes a party of the agreement and instrument from the beginning.

Id. at 1077, 137 S.W.2d at 262. The rule of Childs was explicitly adopted in Mutual Finance Co. v. Martin, 63 So. 2d 649 (Fla. 1953).


24 E.g., Palmer v. Associates Discount Corp., 194 F.2d 225, 228 (D.C. Cir. 1941); Calvert Credit Corp. v. Williams, 244 A.2d 494, 496 (D. C. Ct. App. 1968); Int'l Finance Corp. v. Rieger, 272 Minn. 192, 137 N.W.2d 172 (1965).

25 E.g., Financial Credit Corp. v. Williams, 246 Md. 575, 229 A.2d 712 (1967); from facts showing the seller's fraudulent reputation, a high discount rate, and a prior course of dealing, the court declared that the financer "could not consciously ignore the plain facts surrounding the transaction and still maintain that it purchased the instruments in good faith." Id. at 585, 229 A.2d at 716.
B. The Legal Grounds

1. Absence of Good Faith

An assignee of consumer paper claiming to be a holder in due course may be denied preferred status by a declaration that the purchaser failed to meet the Uniform Commercial Code (U.C.C.) prerequisite of good faith. A factual showing of the purchasers' knowledge of the questionable business reputation of the seller, of his prior dealings with the seller, or of his close connection with the seller in this transaction could warrant a legal determination of lack of good faith.

In Star Credit Corporation v. Molina, a New York court relied on the meaning of the term "good faith" as used in the Code to declare that a buyer's defenses could be asserted against an assignee. Noting the Code definition and the Official Comment, the court declared that the term "stands for honesty and perhaps more." The court then went directly to the essential factual issue:

We need not pause in the abstract for a definition of "good faith" appropriate to this case. The evidence demonstrates that:

- Each contract bears on its reverse side a printed assignment form;
- Each contract was in fact assigned within twenty-four hours of its execution;
- Each contract contains provisions dealing with the rights of a "holder" or "assignee" as well as of a seller;
- Star [the assignee] took each contract at a discount of 20 percent from face value;
- The account number noted on each contract by the seller was the account number used by Star;
- Each contract was signed by the seller "subject to approval of Buyer's credit."

From this evidence the court determined that the seller entered into contracts not for the primary purpose of selling goods, "but

22 Uniform Commercial Code § 3-302 (1)(b); W. Va. Code ch. 46, art. 3, § 302 (1) (b) (Michie 1966). The statutory definition of good faith is "Honesty in fact in the conduct or transaction concerned." Uniform Commercial Code § 1-201 (19); W. Va. Code ch. 46, art. 1, § 201 (19) (Michie 1966).


25 "Good Faith" whenever it is used in the Code, means at least what is here stated. Uniform Commercial Code § 1-201, Comment 19.


27 298 N.Y.S.2d at 574.
primarily to obtain commercial paper for assignment." The circumstances warranted the imputation that the assignee "accepted assignments with full knowledge of the seller's conduct and intention," and accordingly the court held that the purchaser was "not an assignee of these contracts 'in good faith.'"

A Pennsylvania Court in *Norman v. World Wide Distributors* reached a similar conclusion after considering the relationship of the seller and a financial institution. Relying on the U.C.C. requirement of good faith and its statutory definition, the court analyzed the factual setting, which included the financer's knowledge of the seller's dubious sales techniques, the seller's frequent changing of name, and a large discount rate. The court determined that these circumstances demanded that the financer inquire into the operation of the seller, and no such inquiry having been made, the financer was held to have knowledge of all that one would have revealed. In denying the protected position to the purchaser for lack of good faith, the court stated:

He who seeks protection as a holder in due course must have dealt fairly and honestly in acquiring the instrument as to the rights of prior parties, and where circumstances are such as to justify the conclusion that the failure to make inquiry arose from a suspicion that inquiry would disclose a vice or defect in the title, the person is not a holder in due course.

This language, suggesting the historical subjective test, is consistent with the realities of business conduct in the consumer financing industry. It is not unrealistic to infer a lack of honesty in relation to the rights of the consumer when the evidence indicates, for example, a consumer defense of fraud by the seller, printed forms supplied by the financing agency, and knowledge of the seller's dubious sales reputation. The objective of creating defense-free consumer paper is readily apparent from such evidence, and the factual circumstances manifesting a symbiotic seller-financer relationship together with the unlawful techniques of the seller easily defeat a claim of "honest" acquisition of the instruments.

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28 Id.
29 298 N.Y.S.2d at 574-75.
31 Id. at 58, 195 A.2d at 118.
32 Id.
This approach to the definition of good faith has not gone without criticism. In recalling the historical objective-subjective dichotomy, some writers argue that such cases violate the legislative history of the concept of good faith. In contrast to the later drafts, two early drafts of the U.C.C. included with the good-faith requirement an additional clause compelling the observance of "reasonable commercial standards." The later elimination of this clause is said to support the contention that a subjective test for the meaning of "good faith" was intended by the drafters of the Code. It is just as rational to argue, however, that due to the controversy over this section the real intent was to state a definition so ambiguous as to be offensive to no one, thereby leaving the issue for the courts. This is, in fact, what has happened.

The courts in Molina and Norman, applying the good-faith requirement, clearly recognized the realities in the consumer sales paper industry. A showing of circumstances indicating close seller-finance ties warrants a finding of lack of honesty, in that many circumstances of business interrelationship manifest an intent to create consumer paper in order to subvert the consumers' rights. Other courts relying on the "good faith" requirement of the U.C.C. holder-in-due-course concept have found a lack of good faith based on seller-finance involvement without articulating their reasons.

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34The 1949 draft prescribed the holder in due course prerequisites as they now stand but defined "good faith" as follows: "Good Faith' means honesty in fact in the conduct or transaction concerned. Good faith includes good faith toward all prior parties and observance by a person of the reasonable commercial standards of any business or trade in which he is engaged. UNIFORM COMMERCIAL CODE § 1-201(16) (1949 Draft).

The 1952 draft prescribed the current definition of the term "good faith," but included in the statute prescribing the pre-conditions the requirement that the assignee take the instrument "in good faith including observance of the reasonable commercial standards of any business in which the holder may be engaged . . ." UNIFORM COMMERCIAL CODE § 3-302(1) (b) (1952 Draft).


36See Id.

37E.g., American Plan Corp. v. Woods, 16 Ohio App. 2d 1, 45 Ohio Op. 2d 2, 240 N.E.2d 886 (1968). From the evidence that (1) the assignee approved arrangement to buy notes from seller, (2) the assignee supplied the form instruments, (3) the assignee reserved the right to refuse notes, and (4) the assignee investigated the credit of each buyer, the court, noting the U.C.C. requirement of good faith, denied preferred status to the finance company because of the close relationship, citing a host of pre-Code decisions.
2. Notice

The U.C.C. provision requiring that a purchaser be without notice of any defense to be accorded the status of a holder in due course has been employed by courts on numerous occasions to deny the protected status to a purchaser. The statutory definition of notice, including both actual knowledge and reason to know, is sufficiently broad to permit courts to prohibit inequities involving a defense of bona fide purchase. "Reason to know" a fact by inference "from all the facts and circumstances" includes that knowledge or those suppositions which can be deduced from knowledge of other facts. The court in United States Finance Company v. Jones discussed this issue thoroughly. Beginning with the definition of notice, the court proceeded to examine the factual circumstances from which it imputed knowledge to the financer. After noting a technical defect in the acknowledgment, the court discussed the fact that the mortgage and certificate of completion were executed on the same date, declaring that taking the instrument under such circumstances "smacks of bad faith." Evidence showing many assignments from the seller to the financer was declared sufficient in itself to impute notice, in that, "[i]t taxes credulity to accept the contention that . . . [the financer] did not have notice of . . . [the seller's] fraud and manner of dealing with people from his many transactions with [the financer] . . . ." The court indicated that the fifty percent discount rate was not in itself sufficient to constitute notice, but with other suspicious circumstances would be sufficient to warrant a finding of notice. The court then declared that, within the meaning of the U.C.C.'s definition of notice, the financer "was not a holder in due course, since it, through its agents, servants or employees had knowledge,
or had possession of knowledge of facts sufficient to impute knowledge.\footnote{45}

This concept of notice enunciated in Jones is realistic in light of the mode of operation of the consumer financing industry. Knowledge of certain facts does give "reason to know" the seller's dealings within the meaning of the "notice" definition. Finance companies dealing in consumer paper have a wealth of information available to them concerning the sellers from whom they purchase commercial paper.\footnote{46} Knowledge of the business reputation of the seller acquired from such sources as Dun & Bradstreet, Better Business Bureau, and fellow financial institutions is well known to them before they make purchases from the sellers.\footnote{47} Generally the financing agency checks with suppliers and other businesses who might have dealt with the seller. Many contact the consumer by telephone and even conduct on-site inspections of the seller's work. Though "reason to know" may not be present in strict commercial paper situations\footnote{48} in which the dealings can more nearly be described as arm's length, the transfer of consumer sales paper invariably involves a business relationship between the transferor and transferee.\footnote{49} Consistent with this business relationship, the "reason to know" provision has been construed by some courts, and rationally so, to impose a duty to inquire into the circumstances of each transaction before purchasing sales obligations.\footnote{50}

\footnote{45} Id. at 109, 229, So.2d at 498.

\footnote{46} For the empirical study of the issues, see Note, A Case Study of the Impact of Consumer Legislation: The Elimination of Negotiability and the Cooling-Off Period, 78 Yale L.J. 618 (1969).

\footnote{47} Often this is the basic determinant of the discount rate the financier will offer the seller for the paper.

\footnote{48} For example, in Bowling Green, Inc. v. State Street Bank & Trust Co., 307 F. Supp. 648 (D. Mass. 1969), the court held that the assignee's knowledge of the payee's insolvency did not constitute "facts and circumstances" that would give it "reason to know" within the meaning of the U.C.C. definition of notice of a defense of fraud by the maker. This case was upheld on appeal—see note 49 infra.

\footnote{49} The First Circuit has pointed out in an extensive discussion that the circumstances involving a consumer note and a bill of exchange are manifestly distinct: The court explained that a consumer-maker of a note has no way to investigate the honesty of the person with whom he deals, while a bank or finance company finds it easy to check the honesty and competence of those who regularly present consumer paper for discounting. Secondly, the court pointed out that with a check being the major method of transfer of funds in commercial practice, the parties naturally expect it to be rapidly negotiated which is not the case with a consumer note. Bowling Green Inc. v. State Street Bank & Trust Co., 425 F.2d 81, 85-86 (1st Cir. 1970).

\footnote{50} An Illinois Court in Winter & Hirsch, Inc. v. Passarelli, 122 Ill. App. 2d 372, 259 N.E.2d 312 (1970), declared that a party had "reason to know" of the
Other courts have relied on the "without notice" requirement of the U.C.C. holder-in-due-course concept to disallow preferred status without going into the statutory definition of notice. A New Jersey court, reciting several factual circumstances, simply stated that the facts warranted a finding that the financer "had actual knowledge (rather than a mere suspicion) of the legal deficiencies in the transaction." Judicial recognition that circumstances of close business involvement are indicative of actual knowledge or "reason to know" within the meaning of the U.C.C. definition of notice has been the most widely accepted technique to deny enhanced status to financial institutions.

defense of usury within the meaning of the U.C.C. definition of notice when the principal amount was not filled in on a note. The court declared:

The intendment of these provisions would seem to be an attempt to prevent those dealing in the commercial world from obtaining various rights when, from a reasonable inquiry into the true facts that person would have discovered that a fact existed which prevented him from obtaining the rights which he was seeking. Under the circumstances . . . it is fair to say that the plaintiff had "reason to know" there was a good defense against the note in question.

'Id. at 392-393, 259 N.E.2d at 317. Though the court was construing together the definition of notice [UNIFORM COMMERCIAL CODE § 1-201 (25)] and a section relating to notice of incompleteness [UNIFORM COMMERCIAL CODE § 3-304 (1) (a)], the court nevertheless said that the definition of notice can impose a duty to make inquiry.

In a case involving the question of good-faith purchase of warehouse receipts the question involved whether a government agency had notice of a lien in favor of the other party. The "facts and circumstances" were: (1) a federal regulation requiring that the purchases be lien-free; and (2) the fact that a tenant farmer could not be expected to be familiar with the state lien statute. From these facts the court ascertained that the federal agency had a duty to make inquiry and thus had "reason to know" of the lien within the statutory definition of notice. Cleveland v. McNabb, 312 F. Supp. 155 (W.D. Tenn. 1970).

E.g., Mountain Fin. Co. v. Powell, 7 U.C.C. Rptg. Serv. 1223 (Colo. App. 1970). From evidence showing (1) the finance company knew that they were purchasing the instruments on the same day they were executed, and (2) the finance company contacted the buyer and told him that any other instruments with the seller were inoperative, the court denied preferred status, finding that the finance company "was fully aware of the nature of the transaction. Although it may have not had actual knowledge of the entire scheme . . . it most assuredly had knowledge of sufficient facts . . . ." Id. at 1225; Sterling Commercial Corp. v. White, 5 U.C.C. Rptg. Serv. 516 (N.Y. Sup. Ct. 1968). From evidence showing (1) the purchase of many obligations, (2) the security interest instrument was to be mailed to the assignee by the recorder, and (3) interrelationship of activities, the court declared that the issue is a factual one of notice, denying a motion for summary judgment.

H.I.M.C. Inv. Co. v. Siciliano, 103 N.J. Super. 27, 36-37, 246 A.2d 502, 507 (1968). The court said the circumstances of (1) proximity of offices, (2) provision in note for payment at office of assignee (3) swift transfer of the note and mortgage and (4) terms of other instruments, illustrated that the financer had actual knowledge.
3. Conspiracy to Defraud

Another possible theory with which to attack a bona fide purchaser allegation in cases involving close seller-financer dealings is by the use of the common law concepts of fraud and conspiracy. Cases in which a maker wishes to assert a defense against a holder generally involve some kind of fraudulent inducement or misrepresentation on the part of the seller. Under the principles of civil conspiracy the holder-financer might be held liable for the fraudulent acts of the seller. A civil conspiracy is a combination or common purpose by two or more persons to do an unlawful act, or to do what is lawful in an unlawful manner.\(^5\) A course of business whereby a seller routinely transfers obligations obtained by him to a financer manifests a prior intent to create commercial paper free from the consumer-assertable defense of fraud, a common purpose in which the financial institutions participates. This, in itself, is a conspiracy but not actionable conspiracy without the requisite unlawful act. Given an unlawful act on the part of the seller (e.g., a misrepresentation) or the financer, together with the common purpose or scheme of creating defense-free commercial paper, conspiracy to commit fraud can be maintained against the seller and financial institution. Proven conspiracy makes the co-conspirators jointly liable for the acts each committed in pursuance of the conspiracy.\(^3\)

For example, in *Franklin v. Green*\(^2\) a Tennessee court held a financer liable for the acts of a contractor by a finding of conspiracy to defraud. Induced by misrepresentations, a homeowner entered into a contract for the rehabilitation of parts of her home for a specified price and monthly payment rate, signing a note and trust deed to secure the indebtedness. The work was only partially completed, and the actual value of the work done was a mere fraction of the contract price. The indebtedness was assigned to a finance company, which at a later date foreclosed when she failed to pay for the incomplete job. The homeowner contended that the salesman, the contractor and the finance company conspired to defraud her, and the lower court held that the proof established a fraudulent conspiracy on their part. Though the appellate court


\(^{54}\) E.g., Porter v. Mack, 50 W. Va. 581, 40 S.E. 459 (1901).

\(^{55}\) 47 Tenn. App. 696, 342 S.W.2d 253 (1960).
did not elaborate upon the relationship of the salesman, contractor, and finance company, the court upheld the finding of conspiracy, declaring that "the intricate schemes . . . to make it appear that they participated separately and independently of each other in the transactions here involved, can avail nothing . . . [a]nd inasmuch as they were engaged in a common enterprise, all are jointly liable."56 Similar issues were presented to the same court in another case, the court again finding a conspiracy between the financier and the seller.57

Though there are no cases involving precisely the factual patterns discussed here, civil conspiracy is clearly recognized in West Virginia,58 and specifically in regard to conspiracy to commit fraud.59 The court has declared that the gist of the action is the injury produced from the unlawful act,60 and that conspiracy need not be proven except as an aggravating circumstance to extend liability to co-conspirators for the unlawful acts of one.61 Proof of conspiracy in this jurisdiction is not an excessively difficult matter. "[T]he fact that several persons . . . [participate in an unlawful act], each being aware of the feelings and doings of the other and approving of the result accomplished often affords evidence of a confederation or common purpose sufficient to sustain" a finding of conspiracy.62

In alleging the co-conspiracy of a finance company, the important consideration is what circumstances should be considered indicative of the common purpose within the meaning of a conspiracy. Many factual settings are, in themselves, indicative of a common purpose to defraud the consumer by creating consumer sales paper to defeat consumer-assertable defenses: e.g., prior transactions involving a proportionately large number of com-

56 Id. at 702, 342 S.W.2d at 236. It is noteworthy that in addition to compensatory damages, the court sustained the award of $1000 punitive damages, also with joint liability.
57 Kneeland v. Bruce, 47 Tenn. App. 136, 336 S.W.2d 319 (1960). A distinguishing feature brought out in the evidence was that the financier appeared in the course of dealing with the consumer before the work had begun.
59 Wheeling Ice & Storage Co. v. Conner, 61 W. Va. 111, 55 S.E. 982 (1906). See Id. at 121, 126, 55 S.E. at 986, 988.
plaints, the holder's providing the seller with form instruments, a provision in form instruments for payment at the office of the assignee, or consistent swift transfer of consumer sales paper. Other suspicious circumstances should also be considered as circumstantial. It is not necessary to prove a conspiracy by direct evidence; circumstantial evidence merely showing a continuous course of dealing is sufficient. Conspiracy may be inferred from actions of the parties if it is shown that they pursued the same unlawful goal, each doing apparently independent acts but with a concurrence of sentiment.\(^6\) It is important to note that evidence of prior similar acts is admissible to show circumstantially a common purpose or scheme.\(^6\)

Though there has been no widespread use of this legal theory to defeat the protected position of holders of consumer sales paper, its use should not be overlooked in controversies involving close seller-financer relationships. The application of the concept would, of course, defeat the preferred status argument of financers, as would the application of the U.C.C. statutory definitions discussed above. The consumer's reliance on this theory, either independently or in addition to the statutory definitions, has the added significance of permitting the financer to be held jointly liable for punitive damages arising out of the seller's unlawful acts.\(^6\)

4. Other Arguments

One writer has suggested still another solution to the inequities imposed by a strict adherence to the formalities of the holder-in-due-course concept.\(^6\) Underlying this suggestion is the contention that reliance on the good-faith and notice provisions to invalidate purchases of consumer paper without proof of actual knowledge of consumer defenses is erroneous and contrary to legislative intent. The suggested solution lies within section 3-305(2) of the U.C.C., which provides that a holder in due course "takes the instrument free from ... all defenses of any party to the instrument with whom he has not dealt . . . ."\(^6\) It is argued that

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\(^6\) E.g., Mason v. Funderburk, 446 S.W.2d 543, 548 (Ark. 1969).


\(^6\) E.g., Byers Bros. v. Campbell, 353 S.W.2d 102 (Mo. App. 1961); El Ranco, Inc. v. First Nat'l Bank, 406 F.2d 1205 (9th Cir. 1969).


\(^6\) UNIFORM COMMERCIAL CODE § 3-305 (2); W. VA. CODE ch. 46, art. 3, § 305 (2) (Michie 1966).
the close business relationship between the seller and financer demands that the buyer be considered a party with whom the finance company has *dealt*. Thus the buyer's personal defenses are available to him against the financer.\(^{68}\) This rationale presupposes a liberal interpretation of the statutorily-undefined, magic word "*dealt*". This solution, however, offers no more certainty of application than the more traditional approaches and has marked weaknesses. The financer, if confronted with this argument in a suit by a defrauded buyer, could argue that the section should be inapplicable for it only applies to defenses.\(^{69}\) Secondly, this solution would leave every court free to define "*dealt*" to its own satisfaction, thereby introducing additional jurisdictional variations into the holder-in-duty-course concept. Each court would then be left to a determination of the nature and extent of financer involvement, just as was necessary in applying the basically undefined N.I.L. requirements.\(^{70}\)

C. The Factual Circumstances

Although legislative prohibition might be preferable, a strong judicial pronouncement in this jurisdiction could be an effective curb on this consumer sales practice. A forceful declaration would be required that any one of a number of circumstances indicating financial institution involvement is, in itself, sufficient to deny holder-in-duty-course status to the purchaser of consumer sales paper. In developing such a declaration two points should be considered: (1) the circumstances indicative of substantial financer involvement, and (2) the legal theory or theories applicable to the finding.

The initial inquiry relates to circumstances adequate to warrant a finding of finance company involvement. Although the West Virginia Supreme Court of Appeals has never been presented with any significant cases involving an assignee of consumer sales paper, it has on a number of occasions denied preferred status to a holder of commercial paper. In cases decided in this jurisdiction pursuant to the N.I.L., evidence showing close payee-assignee rela-


\(^{69}\) Id.

\(^{70}\) See text at section A *supra*. 
tionships, large discounts, circumlocation of paper, knowledge of the bad reputation of the assignor, transfer without endorsement, usury, and preparation of forms by the assignee have been considered sufficient to deny the purchaser the status of a holder in due course. In particular the West Virginia Court has declared that a general business relationship between payee and assignee of an instrument may be sufficient, in itself, to deny the purchaser protected status.

Although recent U.C.C. cases indicate a trend to deny enhanced status to purchasers of consumer paper, the factual showings requisite to deny preferred status to a holder have not varied significantly with the statutory changes. Financer involvement shown by evidence indicating prior transactions, a large discount, approval of credit terms, and preparation of forms by the assignee have been considered sufficient to deny the purchaser the status of a holder in due course. In particular the West Virginia Court has declared that a general business relationship between payee and assignee of an instrument may be sufficient, in itself, to deny the purchaser protected status.


Marion Nat'l Bank v. Hardin, 83 W. Va. 119, 125, 97 S.E. 600, 602 (1918).


Hall v. Mortgage Security Corp., 119 W. Va. 140, 142, 145, 192 S.E. 145, 149-50 (1937). Though not an issue in the case the court pointed out that the assignee could not be a holder in due course because it had prepared the loan contract forms.

"It is well settled that a general business relation between the payee and the holder may be considered as giving character to a particular transaction, and as affording an inference that a paper discounted within it was so discounted with constructive notice of any existing infirmity." Maryland Fin. Corp. v. Peoples Bank, 99 W. Va. 230, 238, 128 S.E. 294, 296 (1925).

See cases cited in notes 81-89 infra.

Compare text at notes 81-89, with text at notes 90-99, and with text at notes 100-107 infra.


ments, assignor directing recorded instruments to be mailed to the assignee, provision in the note for payment at the office of the assignee, swift transfer of paper, and knowledge of the seller's sales techniques, separately or in various combinations, have been sufficient to deny enhanced status to the purchaser in cases decided under the U.C.C. In recent cases involving contracts executed prior to the effective date of the U.C.C., showing of a prior course of dealing, assignee procurement of credit life insurance, investigation of maker's credit, approval of credit terms, furnishing form instruments, high discount rate, portion of financer's business which flows from seller, portion of seller's business which goes to the financial institution, assignee's name on instruments, and knowledge of seller's bad reputation also warranted a prohibition of enhanced status. In controversies decided pursuant to the N.I.L. provisions on common law principles, evidence of swift transfer, financer's name on
instruments, checking of consumer’s credit before purchase, knowledge of the details of the transaction, knowledge of poor quality sales goods, obtaining insurance for purchaser, knowledge of seller’s financial status, and furnishing form instruments, separately or in various combinations were sufficiently indicative of financier involvement to warrant the denial of good-faith purchaser status.

After a determination that certain factors indicating substantial financial institution involvement are present, the issue turns to what legal theory is to be applied. The court presented this question can declare that certain minimal factual circumstances constitute a showing of lack of “honesty” in terms of the realities of the consumer paper industry and under the statutory definition of good faith. Or the court can declare that these factual circumstances constitute facts giving the financer “reason to know” of buyer defenses within the statutory definition of notice. Or the court can find that certain facts showing financer-seller involvement are indicative of a common purpose and thereby constitute a conspiracy within the meaning of the common law definition. Whichever theory is applied, facts showing substantial finance company involvement warrant a denial of preferred status.

Conclusion

Absent legislative action, the manifest injustice to the consumer that has resulted from the sharp practices of some sellers

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101 Palmer v. Associates Discount Corp., 124 F.2d 225 (D.C. Cir. 1941); Mutual Fin. Co. v. Martin, 63 So. 2d 649 (Fla. 1958); Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W.2d 260 (1940); But see Swanson v. Commercial Acceptance Corp., 381 F.2d 296 (9th Cir. 1967); Mann v. Leasko, 179 Cal. App. 2d 692, 4 Cal. Repr. 124 (1960); Implement Credit Corp. v. Elsinger, 268 Wis. 143, 66 N.W.2d 657 (1954).

102 Mutual Fin. Co. v. Martin, 63 So. 2d 649 (Fla. 1953); But see Swanson v. Commercial Acceptance Corp., 381 F.2d 296 (9th Cir. 1967); Universal CIT Credit Corp. v. Ingel, 347 Mass. 119, 196 N.E.2d 847 (1964).


107 Id.; Mutual Fin. Co. v. Martin, 63 So. 2d 649 (Fla. 1953); Commercial Credit Co. v. Childs, 199 Ark. 1075, 137 S.W. 2d 260 (1940); International Fin-Corp. v. Rieger, 272 Minn. 192, 137 N.W.2d 172 (1963).

108 See text at section B-1, supra.

109 See text at section B-2, supra.

110 See text at section B-3, supra.