Completing the Legal Definition of "Negotiability" Using Monetary Theory

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I. INTRODUCTION

In *Republic v. Sandiganbayan*,[1] a question arose as to whether blank shares of stock may be treated as negotiable instruments. The Supreme Court ruled:

> The PCGG assumes that the stock certificates are negotiable. They are not.
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> > Although a stock certificate is sometimes regarded as quasi-negotiable, in the sense that it may be transferred by delivery, it is well settled that the instrument is non-negotiable, because the holder thereof takes it without prejudice to such rights or defenses as the registered owner or creditor may have under the law, except insofar as such rights or defenses are subject to the limitations imposed by the principles governing estoppel.
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> That the PCGG found the stock certificates endorsed in blank does not necessarily make it the owner of the shares represented therein.[2]

The pronouncement on the classification of shares of stock as a non-negotiable instrument is precise. When the concept of estoppel was however mentioned as an exception to the general rule that a stock certificate cannot be a negotiable instrument, the precision was compromised. The statement now becomes ambivalent. It can be interpreted that estoppel can either make a non-negotiable stock certificate into one, or merely prevent the claimant from enforcing a right.

The statement can be seen to have its roots from the inaccurate definition of the term "negotiability." The concept of negotiability is not properly defined, as had been usually done, by only looking at the rights available to a subsequent transferee, such as when one says: *a document is non-negotiable because "the holder thereof takes it without prejudice to such rights or defenses as the registered owner or creditor may have under the law."* It requires much more.

The following discussion will prove this thesis by comparing the manner by which money is used in the legal world with the manner by which the facets of money have been tempered by the creation of a negotiable instrument.

Primarily, money is used as a medium of payment. However, because of the inevitable dangers associated with using money, negotiable instruments which were first used by early merchants was given imprimatur by the law.

The Negotiable Instruments Law,[3] which created the negotiable instrument device, seeks to provide rules and regulations regarding payments or performance of monetary obligations using money substitute media.[4] The difference between the manner by which money and negotiable instruments are transacted should define what negotiability means. This definition necessarily includes the taking of the instrument subject to certain defenses as quoted by the aforementioned case.

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1. Republic v. Sandiganbayan, 402 SCRA 84 (2003).

2. *Id.* at 107.

3. Negotiable Instruments Law, Act No. 2031 (1911).

4. Jose Marlon P. Pabiton, *Utilizing an Integrative Analytical Framework to Extract Negotiable Instruments Law Principles*, 48 ATENEO L. J. 248, 265 (2003).

The answer to the question: *what makes an instrument negotiable?* lies in Section 1[5] of the Negotiable Instruments Law. As will be shown later, the law itself impliedly admits that such definition is imprecise.

Because the concept of negotiability connotes a whole gamut of concepts that will be summarized in this note, it would become clearer that the concept of estoppel –which prevents a party from reneging on a representation– cannot make an instrument that does not qualify as a negotiable instrument into one.

This note will look into, and compare how money instruments and negotiable instruments work to prove the abovementioned thesis.

II. HISTORY OF MONEY

The earliest accounts of coinage date as far back as 7TH century B.C. in Athens, Greece.[6] Yet "one undisputed fact in the history of money is that coins were not the first money."[7] In fact, "coinage was a surprisingly late addition to the human heritage of economic knowledge."[8] The first forms of money were probably some white shells from a small mollusk found in the shallow spots of the Indian Ocean.[9]

But why did it ever occur to the first humans to create a monetary system in the first place?[10] A study of the early tribes of Australia and the moneyless societies leads us to the explanation of the adage "necessity is the root of all inventions."

5. *Form of negotiable instruments.* - An instrument to be negotiable must conform to the following requirements:
   (a) It must be in writing and signed by the maker or drawer;
   (b) Must contain an unconditional promise or order to pay a sum certain in money;
   (c) Must be payable on demand, or at a fixed or determinable future time;
   (d) Must be payable to order or to bearer; and
   (e) Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.
6. NORMAN ANGELL, THE STORY OF MONEY 96 (1929).
7. *Id.* at 73.
8. *Id.*
9. *Id.*
10. *See id.* at 18, as to why some early civilizations, such as China, did not use money and how they conducted their economic life.

The basis of the first exchanges that spurred the need for more material possessions was hospitality among tribal groups.

> The stranger on arriving receives a present which after a certain interval he reciprocates, and at his departure another present is handed him. On both sides wishes may be expressed with regard to these gifts. In this way, it is possible to obtain things required or desired, and success is the more assured [sic] inasmuch as neither party is absolved from the obligations of hospitality until the other declares himself satisfied with the presents. The custom of reciprocal gifts of hospitality permits rare products of land or artistic creations of a tribe to circulate from people to people, and to cover just as wide distance from their origin as in the case of modern trade.
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> This type of contact developed until there arose as between tribes 'a brisk trade in pots, stone hatchets, hammocks, cotton threads, necklaces of mussel shells, and many other products.'[11]

In contrast to the "household" moneyless societies, it can be seen that because of the ability of their "society," –an aggrupation of people which is bigger than a tribal group– to create everything they thought they needed through a division of labor among their members, the necessity of money was not appreciated.

> In the case of moneyless societies [such as] . . . the feudal estate, the manor, the monastery, the remote frontier farm and even, . . . the domain of the Pharoahs, we are dealing with some form of 'household' type of social organization [though sometimes it may have resembled more a prison than a household], where money is no more indispensable than it is between members of the same family. Money was not indispensable, because the essence of the social arrangement did not depend upon an exchange, but upon every one [sic] doing an assigned task and the product being divided by well-established custom or according to traditional hierarchical rights. And where a group is economically self-sufficient there is no need to exchange even with similar groups elsewhere.[12]

Owing to the modernization of transportation, reduced trading distances facilitated human interaction and intensified the awareness of early humans to other implements needed for physical existence. Trade had then been institutionalized as part of human life.

> The explanation by which both parties benefit by exchange is simple enough. Circumstances give one individual more of something he can use, none of some article which he needs, but which another possesses to excess. By changing the one for the other both benefit. On this farm milk

11. ANGELL, *supra* note 6, at 55-56 (citation omitted).
12. *Id.* at 22-23.

> is thrown away, [sic] but the children freeze for lack of coal; in that valley miner's children [sic] die for lack of milk. The exchange will save two groups of lives and enrich both. In all good trades both parties make a profit.[13]

III. BENEFITS OF TRADE AND THE NEED FOR VALUATION

Picking up from the abovementioned example of the benefits of trade, we introduce the concept of surplus or the production of a particular good in an amount more than what such producer believes as necessary.

Person A, who lives in a place abundant with milk producing cows, will naturally produce more milk than he or she needs. On the other hand, Person B, who lives near a mining pit full of coal minerals, will have more coal than he or she needs. And with this surplus, trading becomes a positive solution. The surplus milk could be exchanged for surplus coal. The children living in the cow farming community need not suffer the cold; children living in the mining community could be nourished.

Physical existence however means more than living with coal and milk; there are other necessary things. With such premise, the barter system became extremely difficult. How much milk or coal can be exchanged for clothes or salt or rice grains, and vice versa? The early traders realized this problem and resorted to the money-solution device.

> The bargaining must have been extremely difficult, and we know that before long the Greeks came to money as a way out of the difficulty. But what is noteworthy [sic] when the Greeks [who first democratized it, and on the whole used it more successfully than any ancient people] did come to money. . .[14]

The money-solution device sought to have a universal benchmark from which, the value of other traded items were measured. This solution created a new set of problems: Valuation of quantity and quality.

How much milk is equal to the value of other goods? How much milk, produced by a healthy cow, is equal to the value of other goods, as compared to milk produced by an unhealthy cow? A completely abstract standard is an extremely difficult, perhaps impossible, idea.[15] The Iliad gives us a picture of the confusing situation when "Homer laughs at the folly of

13. *Id.* at 58.
14. *Id.* at 59.
15. *Id.* at 58.

Glaucus, who exchanged his golden armor, worth one hundred oxen, for the bronze armor of Diomede, worth only nine oxen. . ."[16]

In much of the ancient Europe of Homer's day, cattle were the usual medium of exchange. Hence the Latin word *pecunia* (money, from *pecus*, cattle). In our own language, the word "cattle," or "chattel," has come to include all property.[17]

From the other side of the globe, the same pattern of trading behavior can be seen. This fact, when compared to the Roman societies, is quite surprising due to its temporal proximity to the modern ages. Up to 1670, the people of Massachusetts used corn and cattle money.[18] While

> [m]any other commodities were used as money in the different colonies; Rhode Island, for instance, [used] wool [as] a standard of value for assessing rates in 1674; . . .South Carolina as late as 1720 made rice legal tender for the payment of taxes, whilst sugar, rum, molasses, indigo, and skins all served as money at different times and in different localities.[19]

Although most numismatists believe that even if the first to use coins were Lydian merchants and not the state or the kings,[20] they all seem to concur that unfavorable experiences in engaging in trade with the use of money bolstered the need to create a centralized government authority that eliminates problems peculiar to using tangible materials as representatives of value concepts.

Like in the days of Homer, and the budding days of the American state unification, a centralized authority, such as the government and the church, seemed to have solved the problem of valuation.

> In early times[,] the temples had been responsible for issuing money. This may have come about in several ways. As soon as coinage appeared it was extremely important, of course, to insure that the hallmark of genuineness was not lightly given, and would be one likely to impress the people and cause acceptance of this new thing. Further, metallic reserves in the shape of bars of metal against the need of war time or other catastrophe were kept in the temples, possibly with the feeling that by placing these reserves under the protection of the gods, sacrilege would be added to the crime of theft.[21]

16. *Id.* at 59.
17. *Id.* at 78.
18. *Id.* at 85.
19. *Id.*
20. *See generally Id.* at 83.
21. *Id.* at 96.

Further, when the Greek cities adhered to silver coinage, the silver raw materials that were sourced from the mines of "Laurium , . . were the property of the government."[22]

This kind of attitude, securing the private ownership of money and its corollary principle of defending it from thieves, is essentially a reflection of the efficacy of money to represent wealth.

> Aristotle seems to have held clearly to the distinction between money and wealth, which it is so difficult [sic] for the ordinary man to maintain once he has become accustomed to the use of money and to seeing it that it can usually be exchanged for wealth.
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> The evolution of money, the functions of money, the influence of money on mankind, the qualities of the money material, and the value of money, were all discussed by Greek thinkers. . . Money's service as a medium of exchange and measure of value [or store of value] was clearly recognized.[23]

IV. Characteristics of Money

The first lawyer known by history to have defined money was Savigny, a German jurist of the 16TH and 17TH centuries. His expression, which was essentially drawn from the theory of Economics, had, according to F. A. Mann, been correctly approved by the law. Savigny explains:

> In the first place money appears in the function of a mere instrument for measuring the value of individual parts of wealth. As regards this function, money stands on the same basis as other instruments of measurement . . . But money also appears in a second higher function, *viz.* it embraces the value itself which is measured by it, and thus represents the value of all other items of wealth. Therefore ownership over money gives the same power which assets are measured thereby are able to give, and money thus appears to be an abstract means to dissolve all property into mere quantities. Therefore money gives its owner a general wealth power, applicable to all objects of free intercourse, and in its second function it appears as an independent bearer of such power, placed at the side power, placed at the side of, and equivalent to, and equally efficient as all particular objects of wealth. Such wealth power, characterizing money, has, moreover, the attribute of being independent of individual abilities and necessities, and consequently of having equal usefulness for all and under all circumstances.[24]

22. *Id.* at 95.

23. *Id.* at 93.

24. F. A. MANN, THE LEGAL ASPECT OF MONEY, 28 (5d ed. 1992).

In a 1970 simplification, Mr. Justice Blackstone in *Wright v. Reed*[25] said that money is:

> The medium of commerce. . .a universal medium, or common standard by comparison with which the value of all merchandise may be ascertained, or it is a sign which represents the respective values of all commodities.[26]

Money, which had effectively been used as a device to solve trading problems, now became dangerous items for traders.

> The danger attending all public accumulations of the precious metals [or money devices] is exemplified by what occurred in this instance; for, says Athenaeus, the Arcadians were no sooner entrusted with this treasure, than they picked a quarrel with the Lacedaemonians, with the express view of seizing upon it as part of the spoils of war.[27]

These conceptions, however old, seem to have had a universal appeal. Even during these modern times, economic theory and legal policy define money as "purchasing power in terms of wealth in general," and with it, the reality that "wealth is power."[28]

V. The Negotiable Instrument Solution

Considering the danger of having in one's possession, articles of great value such as money, and its inherent facet of easy transferability of ownership, early traders devised a scheme to temper the disadvantages of being prey to thieves of and the consequent effects of losing all their wealth while still preserving the main facet of money –to facilitate trade.

> The use of negotiable instruments originated from the merchants and traders of the Middle Ages, more specifically among the Florentine and Venetian merchants along the Adriatic Sea. The bill of exchange was devised to facilitate the contract of *cambium* and to avoid the risks of transporting money.[29]

The English Bill of Exchange Act passed by Parliament in 1882, which is essentially the law on negotiable instruments in England, was copied and approved by the United States through the National Conference of Commissioners on Uniform State Laws in 1896. On 3 February 1911, with the verbatim reproduction and promulgation of the Uniform Negotiable

25. Wright v. Reed, 3 T. R. 554 (1970).

26. MANN, *supra* note 24, at 7.

27. *Id.* at 99.

28. *Id.* at 28.

29. JOSE C. CAMPOS JR. & MARIA CLARA LOPEZ-CAMPOS, NOTES AND SELECTED CASES ON NEGOTIABLE INSTRUMENTS LAW 6 (4d ed. 1990).

Instruments Law of the United States, Act No. 2031 was published in the Official Gazette and took effect 90 days thereafter.[30]

VI. Comparison Between Money and the Negotiable Instrument Device to Determine the Other Unstated Facets of the Concept of Negotiability

From Blackstone's definition of money, one can cull the key phrases, "representative value"[31] and "free exchange." We then deconstruct the concept of "free exchangeability" of money and compare such facet with the concept of transferability of a negotiable instrument. Through this comparison, it will be shown that the concept of negotiability means much more than just taking "it without prejudice to such rights or defenses" as the prior owner or indorser.

The concept of "free exchangeability" can be seen from two perspectives; the manner of physical transfer and the conceptual rights appertaining to the transferee.

VII. Physical Transfer

With money, mere possession gives the presumption that the previous physical transfer is valid, or cannot be questioned. With a negotiable instrument, Section 30 provides that an order instrument has to be indorsed and delivered; whereas a bearer instrument has to be delivered.

Thus, inquiry into the physical possession of a negotiable instrument, payable to order, can move from a conceptual level, which involves the analysis of intentions,[32] to the physical level, which involves the analysis of form.[33] This limitation is not however borne by a bearer instrument, thus giving it a closer approximation to the manner by which money is physically transferred.

30. *See id. See also* VIRGINIA M. DIAZ, HANDBOOK ON NEGOTIABLE INSTRUMENTS 1 (3d. ed. 1993).

31. Since the concept of value is basically a study that falls within the realm of economic theory, we cease to explore this topic further.

32. This analysis of intentions can range from the inquiry as to whether the indorser made a restrictive, qualified, or conditional indorsement as defined by Sections 36, 38, and 39 respectively.

33. As to form, see discussions under *IX A, 2, a, Infra* on The Instrument Must be Complete and Regular on its face.

VIII. Rights Appertaining to the Transferee

Unlike money, which is accepted as a means of payment; payments on monetary obligations using a negotiable instrument medium is recognized only upon the encashment of the instrument.[34] Jurisprudence explains that this is occurs because unlike money, a negotiable instrument is not legal tender.[35]

But beyond such an explanation lies the unsaid presumption that the payor, when using money to pay an obligation, is deemed by law as the owner of the money, who has the unlimited right to dispose or pass ownership of the medium by which he or she effects payment. This presumption is made apparent when the concept of the rights of a holder of a negotiable instrument is examined.

Though ambiguously defined, the Negotiable Instruments Law seems to have created three types of holders with different degrees of available rights: (1) a holder in due course; (2) a holder not in due course; and a (3) non-holder. It becomes worthy to note at this point that Section 26 seems to create another type of holder called a holder for value. As will be shown later however, the fact of being a holder for value is but a requisite for one to become a holder in due course and is not a final status.

These definitions can be understood using the process of elimination. After having identified the elements necessary to become a holder in due course, defining the other types of holders can be done by determining what, among the elements needed to be a holder in due course, is missing.

IX. Holder in Due Course

A. The Fact of Being a Holder in Due Course

The Negotiable Instruments Law defines a holder in due course by stating the conditions that have to be present at the time the instrument is negotiated. They are found in Section 52. But a more thorough search of the law itself, and jurisprudential pronouncements would reveal, that Section 52 alone is insufficient.

To become a holder in due course, one must: (1) be the holder of an instrument as defined in Section 191; (2) comply with Section 52; (3) have been negotiated to the person claiming to be a holder in due course at a reasonable time after its issue as provided by Section 53; and (4) not have

34. An Act to Ordain and Institute the Civil Code of the Philippines, Republic Act 386 as amended, art.1249 (1950).

35. Philippine Airlines v. Court of Appeals, 181 SCRA 557 (1990),

been previously bound on the instrument before he became a holder in due course as provided by *Fossum v. Fernandez Hermanos*.[36]

1. Holder as per Section 191

A person can be a holder only after a proper process of transfer. An order instrument has to be indorsed as per Section 30. On the other hand, a bearer instrument closely approximates the free transferability facet of money as it can be properly negotiated by delivery.

2. Holder in Due Course Must Comply with Section 52

Section 52 provides that a holder in due course is a holder who has taken the instrument under the following conditions: (a) that it is complete and regular upon its face; (b) that he became the holder of it before it was overdue and without notice that it had been previously dishonored, if such was the fact; (c) that he took it in good faith and for value; and (d) that at the time it was negotiated to him, he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it.

This enumeration of technical requirements hails the use of all other sections, and requires the appreciation of all other concepts that have been brought to existence by the Negotiable Instruments Law.

a. The Instrument Must be Complete and Regular on its Face

The fulfillment of the first requisite is discussed by the law from the perspective of defenses and equities and will be discussed under such subject matter. But generally, the requirement of "completeness"[37] of an instrument is addressed by Sections 14 and 15 while the requirement of "regularity"[38] of an instrument is addressed by Section 124.

36. 44 Phil 711 (1923).

37. Completeness is discussed from the perspective of incompleteness. In Section 14, to be incomplete means to be wanting in any material particular.

38. Regularity is discussed by Section 124 from the perspective of material alteration.

b. Instrument Must have been Taken Before It Was Overdue and Without Notice of Dishonor if Such was the Fact

If the instrument has a maturity date, then it is overdue after such date; while an instrument payable on demand is overdue when presented for payment[39] or indorsed after an unreasonable time after its issue. As to what is reasonable time, Section 193 provides that regard is to be made on the nature of the instrument, the usage of trade, and particular facts of the case. Hence, the facts of the case will vary in each case.[40] By express provision of Section 53, an indorsee taking the instrument under these circumstances does not become a holder in due course.

Within the context of this discussion, Section 47 provides that a negotiable instrument ceases to be negotiable when it has been restrictively indorsed or discharged by payment.[41] Any "negotiation" thereof becomes a mere assignment and the fiction of the Negotiable Instruments Law making an indorsee a holder, or holder in due course for that matter, will not apply.

In *Montinola v. PNB*,[42] Ramos, the disbursing officer of the USAFE negotiated a check to Montinola 2 1/2 years from the date of its issuance; in *Far East Realty v. Court of Appeals*,[43] a check, payable on demand was drawn on 3 September 1960 and was presented for payment on 5 March 1964. On the otherhand, in *Stelco Marketing Corp v. Court of Appeals*,[44] Stelco became the holder of a check after it was dishonored. Under such circumstances, the Court found them to be not holders in due course.

c. The Instrument Must Have Been Taken in Good Faith and for Value

Discussions made by authors regarding "good faith" under Section 52 (c) is usually intertwined with discussions on "notice of infirmity in the instrument or defect in the title of the person negotiating it" under Section 52 (d). But a review of jurisprudence shows that these two concepts can be discussed separately.

39. *See* CESAR L. VILLANUEVA, PHILIPPINE COMMERCIAL LAW 252 (1998) [hereinafter VILLANUEVA].

40. CAMPOS AND LOPEZ-CAMPOS, *supra* note 29, at 165 (citing McLean v. Bryer, 42 Atl. 373).

41. *See id.*, VILLANUEVA, *supra* note 38, at 252.

42. Montinola v. PNB, 88 Phil. 178 (1951).

43. Far East Realty v. Court of Appeals, 106 SCRA 256 (1988).

44. Stelco Marketing Corp. v. Court of Appeals, 210 SCRA 51(1992).

In *De Ocampo v. Gatchalian*,[45] Dr. V.R. de Ocampo received a crossed check from Manuel Gonzales to pay for the medical bills Manuel's wife. The payee on the check was Dr. de Ocampo and the drawer was Anita Gatchalian. Gatchalian however, merely issued the note to Gonzales as a sign of her willingness to purchase a motor vehicle that Gonzales was allegedly selling. In ruling that de Ocampo was in bad faith, the Supreme Court said:

> The stipulation of facts expressly states that plaintiff appellee was not aware of the circumstances under which the check was delivered to Manuel Gonzales, but we agree with the defendants-appellants that the circumstances indicated by them in their briefs, such as the fact that the appellants [Gatchalian] had no obligation or liability to the Ocampo Clinic; that the amount of the check did not correspond exactly with the obligation of Matilde Gonzales to Dr. V.R. de Ocampo; and that the checks had two parallel lines in the upper left hand corner, which practice means that the check could only be deposited but may not be converted to cash – all these circumstances should have put the plaintiff-appellee to inquiry as to why and wherefore of the possession of the check by Manuel Gonzales, and why he used it to pay Matilde's account.
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> Having failed in this respect, we must declare that plaintiff-appellee was guilty of gross neglect in not finding out the nature of the title and possession of Manuel Gonzales, amounting to legal absence of good faith, and he may not be considered as a holder of the check in good faith.[46]

In *State Investment House v. Court of Appeals and Spouses Chua*,[47] the Supreme Court relied on the ruling in *De Ocampo* when it adjudged State Investment House as a holder not in due course of a crossed check. It said:

> [T]he act of crossing the check serves as a warning to the holder that the check has been issued for a definite purpose so that he must inquire if he has received the check pursuant to that purpose, otherwise he is not a holder in due course.[48]

Although the phrase "taking an instrument for value" in Section 52 (c) as a requisite for one to be holder in due course is incorporated into the

45. De Ocampo v. Gatchalian, 3 SCRA 596 (1961); *See also* Bataan Cigar v. Court of Appeals, 230 SCRA 643 (1994), which held that failure to inquire into a crossed check amounts to taking an instrument in bad faith.

46. *Id.* at 603.

47. 175 SCRA 311 (1989).

48. *Id.* At 315. *See* also *Bataan Cigar and Cigarette Factory Inc. v. Court of Appeals*, 230 SCRA 643 (1994) where State Investment House was adjudged as a holder not in due course of a crossed check for not inquiring into the fact that the check it received was a crossed check.

sentence that includes "good faith," this phrase is more potent than how it is presented.

Value is defined by Section 25 as any consideration sufficient to support a contract such as an antecedent debt but does not include love and affection.[49] Section 24 then provides the presumption that every negotiable instrument is *prima facie* deemed to have been issued for valuable consideration, and that every person whose signature appears thereon became a party for value.

Despite the abovementioned sections, the law still introduces the concept of a holder for value. As earlier proposed, a holder for value is but a description and not another entity in the negotiable instruments law such that the negotiable instruments law recognizes only two types of holders. This is because unlike a holder in due course and holder not in due course, whom the law defines and arms with certain rights and liabilities, such concepts have not been given to a holder for value although the law uses the phrase "what constitutes a holder for value."

Thus it may be said that a holder in due course must be a holder for value but a holder for value may or may not be a holder in due course. And to be a holder for value one must comply with either Section 26 or 27.

Under Section 26, a holder for value is one who takes an instrument, paying a value therefore, from a holder for value. Hence, to be a holder for value means complying with two requisites: (1) to pay a value for the instrument, and (2) to take it from one who previously took the instrument and paid value for such. Under Section 27, a holder can be a holder for value up to the extent of his lien on the instrument, if any exists.

But what is the significance of being a holder for value besides being a requisite for one to be a holder in due course? The answer is given by Section 29 stating that an accommodation party is liable to a holder for value even if he, the holder for value, knew that the party he is dealing with is just an accommodation party who signed the instrument without giving value but only to lend his name.

Thus in *Ang Tiong v. Ting*,[50] although an obiter, the Supreme Court said that even if Felipe Ang was an accommodation indorser, he would still be liable to Ang Tiong, a holder for value, even if he (Ang Tiong) knew that Felipe Ang was an accommodation indorser.

49. *See* VILLANUEVA, *supra* note 38, at 254.

50. Ang Tiong v. Ting, 130 Phil. 741 (1968).

d. That there was no Notice of Infirmity or Defect in the Title of the Person Negotiating the Instrument

Notice of infirmity of an instrument, although not expressly defined by the Negotiable Instruments Law had been defined in *Mesina v. Intermediate Appellate Court.*[51] In this case, a stolen manager's check was indorsed to Mesina, and, when it was dishonored, he refused to say how and why it was passed to him. The Supreme Court concluded that he therefore had notice of the defect of his title over the check from the start.

Defect in the title of the person negotiating the instrument is defined by Section 55 as that instance when the indorsee obtained the instrument or any signature thereto by fraud, duress, force and fear, or other unlawful means, or for an illegal consideration or when he negotiates it in breach of faith, or under such circumstances amounting to fraud. This long enumeration has followed in many cases:

In *Consolidated Plywood Industries, Inc. v. IFC Leasing and Accptance Corporation,*[52] the Supreme Court held that: since the financing company knew that the seller-assignor's right to the instrument was subject to the condition that the subject matter sold and for which a promissory note was issued was not defective, then such knowledge does not make the financing company not a holder in due course. The Court also pronounced that when a financing company actively participates in transactions of this type from its inception, it can not be a holder in due course.

In *Prudencio v. Court of Appeals,*[53] the Supreme Court held: that PNB was an immediate party or privy to the promissory note, and that the deed of assignment which principally moved the makers to issue the note in favor of PNB included a proviso that payment on such note will be made from the payments to be received from the Bureau of Public Works. Hence the spouses Prudencio, makers of the check, could not be compelled to pay on the note by the bank and such right was made a basis for the court to say that the mortgage which secured the note must be cancelled and the Prudencios should be released thereon.

In *Banco Atlantico v. Auditor General,*[54] the Court held that the mere request of Ambassador Virginia Boncan to the collecting bank, Banco Atlantico, to delay the presentation of the instrument that she encashed as

51. Mesina v. Intermediate Appellate Court, 145 SCRA 497 (1986).

52. Consolidated Plywood v. IFC Leasing, 149 SCRA 449 (1987).

53. Prudencio v. Court of Appeals, 143 SCRA 7 (1986).

54. Banco Atlantico v. Auditor General, 81 Phil. 335 (1978).

payee meant that the bank had actual knowledge of the defect in the title of Boncan.[55]

Further, although notice of infirmity on the instrument or defect in the title of the person negotiating an instrument has been defined by Section 56 as *actual* knowledge such that taking the instrument amounts to bad faith, the Courts expanded the meaning of actual knowledge as something that will excite suspicion without expressly ruling so.

3. Must Comply with *Fossum v. Fernandez Hermanos*

In the case of *Fossum v. Fernandez Hermanos,*[56] the Supreme Court said that:

> The presumption expressed in that section [referring to section 59 on the presumption of a holder in due course] arises only in favor of a person who is a holder in the sense defined in section 191 of the Law, that is, a payee or indorsee who is in possession of the draft, or the bearer thereof. Under this definition, in order to be a holder, one must be in possession of the note or the bearer thereof.[57]

Furthermore, the case stated that the presumption as to the status of one as being a holder in due course is good only as long as one is in the possession of the instrument. Thus, when the instrument is negotiated from a holder in due course to another, the indorsee does not enjoy the presumption that his indorser is a holder in due course; he must prove it. The Supreme Court held that:

> If this action had been instituted by the bank itself, the presumption that the bank was a holder in due course would have arisen from the tenor of the draft and the fact that it was in the bank's possession; but when the instrument passed out of the possession of the bank, and into the possession of the present plaintif, no presumption arises as to the character in which the bank held the paper. The bank's relation to the instrument became past history when it delivered the document to the plaintiff; and it was incumbent upon the plaintiff in this action to show that the bank had in fact acquired the instrument for value and under such conditions as would constitute it a holder in due course.[58]

55. Parenthetically, in this case, the Court noticed that Boncan "materially altered" the checks by increasing the amount payable to her but pronounced that there was a forgery – this could have been the chance for the Court to enrich jurisprudence on the issue of the effects of material alteration.

56. Fossum v. Fernandez Hermanos, 44 Phil 711 (1923).

57. *Id.* at 716.

58. *Id.*

B. Rights, Power, and Weakness of a Holder in Due Course

The rights of the holder in due course are:

1. As a holder of a negotiable instrument, the holder in due course may sue on the instrument in his own name as provided in Section 51;
2. To enforce payment on the instrument for the full amount from any person who may be liable on the instrument, and
3. To be free from any arrangement or defenses of parties prior to him as provided in Section 57;
4. To be free from personal defenses but not real defenses;[59]
5. To enforce payment on the terms of a materially altered instrument prior to its alteration as stated in Section 124 – provided that he is not a party to said alteration.

In addition to that, the holder in due course has the power to make a subsequent indorsee or holder a holder in due course. Section 58 states that:

> [B]ut a holder who derives title from a holder in due course, and who is not a party to the fraud . . ., has all the rights of the former [referring to the holder in due course] in respect of all parties prior to the latter [referring to holders prior to the holder in due course from which this new holder acquired the instrument]

Again, this demonstrates that the law explains the rights/powers of a holder in due course from perspectives other than the holder in due course. In this case, the rights/powers of a holder in due course are explained from the perspective of a holder who is an indorsee of a holder in due course.

But one may ask: Does this mean that the "[r]equisites to be a Holder in Due Course" is unnecessary provided that one acquires an instrument from a holder in due course? The answer is in the negative.

In the case of *Fossum*,[60] Charles A. Fossum became the indorsee of Philippine National Bank. He then tried to collect on the time draft against

59. Defenses are of two kinds, real and personal. Real defenses are available against all holders, including holders in due course, while personal defenses can be raised only as against holders not in due course. Real defenses are those which attach to the instrument itself and generally disclose an absence of one of the essential elements of a contract [such as the legal capacity of the parties, the giving of consent, and the presence of consideration] or where the admitted contract is void for all purposes for reasons of public policy. Personal defenses are those wherein a true contract appears, but where for some reason, such as fraud, the defendant is excused from its obligation to perform. (CAMPOS AND LOPEZ-CAMPOS, *supra* note 29, at 219).

Fernandez Hermanos whom he previously dealt with in his capacity as agent of the American Iron Company (AIC); and as agent of AIC, Fossum knew that the consideration (the tail shaft for the ship Romulus) for which the time draft was issued failed. On the occasion of addressing the issue as to whether or not Fossum is a holder in due course since he acquired the time draft from the bank who was allegedly a holder in due course, the Supreme Court, citing *Dollarhide v. Hopkins* said:

> They [referring to the negotiable instrument] were then indorsed by the plaintiff to a bank which became holder in due course; but afterwards, and before the commencement of the action, the notes were retransferred by the bank to the plaintiff. In an action upon the note the defendant alleged and proved breach of warranty and showed the [sic] plaintiff knew of the defect of the warranty and showed that the plaintiff knew of the defect in the separator and the time he purchased the notes. It was held that the plaintiff could not recover, notwithstanding the fact that the notes had passed through a bank, in whose hands they could not have been subject to the defense which had been interposed.

This only shows that Section 58, which allows a holder who derives his title from a holder in due course and who is not himself a party to any fraud or illegality affecting the instrument has all the rights such as the former holder in respect of all parties prior to the holder. However, this will not arise when the subsequent acquirer or indorsee of the instrument cannot comply with the requirements to become a holder in due course as earlier discussed.

The limited weakness of a holder in due course however is that he cannot compel the maker or payee or anyone who may be required to make payment on the instrument when these aforementioned parties can raise real defenses.

Now that a holder in due course has been defined, by process of elimination, a holder not in due course, its rights, powers, and weaknesses can be defined.

X. HOLDERS NOT IN DUE COURSE

When one is not a holder in due course but the negotiable instrument was correctly indorsed to him, he remains to possess the status of a holder.

Although a holder not in due course can sue on the instrument to compel payment, he cannot (1) be free from any arrangement or defenses of parties prior to him as provided in Section 57; (2) thwart both personal and

60. *Fossum*, 44 Phil 713 (1923).

real defenses; and (3) enforce payment on the terms of a materially altered instrument prior to its alteration as stated in Section 124.

XI. POSSESSORS OF ORDER INSTRUMENTS WITHOUT PROPER NEGOTIATION

Section 49 says that transferring a payable to order negotiable instrument without proper indorsement only "vests in the transferee such title as the transferor had therein" and acquires the right "to have the indorsement of the transferor." The provision has been interpreted by Campos & Campos in this wise: the "vesting of title" means that the transferee who obtained the payable to order instrument without proper indorsement does not enjoy the presumption of ownership. Correlatively, proof of ownership has to be established by a claimant beset by such circumstances. And after proof of ownership is presented, the rights of a holder not in due course can be enforced.[61] Diaz on the otherhand believes that without proper negotiation the transferee will not qualify either as a holder, payee, indorsee or bearer even if the has physical possession of the instrument; he acquires such title as the transferor has. However, he may compel the transferor to correctly negotiate the instrument to him.[62]

This author gives a qualified concurrence to both authors.

True, a person receiving an order instrument is not precluded from enforcing the rights of a holder in due course after certain conditions set by the Negotiable Instruments Law have been complied. This statement of Campos & Campos becomes questionable when they give the impression that the condition required by law to cure such a defect is by proving ownership. Diaz perceives this flaw when she says that even if the transferee is in physical possession of the instrument, the law does not see such possessor as falling into the category of characters created by the Negotiable Instruments Law to use the negotiable instrument device.

Diaz however seems to have failed to further explain the phrase "vests in the transferee such title as the transferor had therein." Campos & Campos on the otherhand seem to have avoided the dilemma by saying that the transferee is not an owner of the instrument. This author believes that the phrase "vests in the transferee such title as the transferor had therein," means that the Civil Code provisions on assignment should apply because the requirements prescribed by the Negotiable Instruments Law have not been complied with. Thus, the situation should be governed by the substantive

61. CAMPOS & LOPEZ-CAMPOS, *supra* note 29, at 94.

62. VIRGINIA M. DIAZ, HANDBOOK ON NEGOTIABLE INSTRUMENTS 45 (3d. ed. 1993).

and not the special law. Section 49 itself would agree with this manner of resolution as it provides that in determining whether the holder is a holder in due course, the time to reckon with is the time of actual indorsement. This phrase impliedly says that only after indorsement, a requisite mandated by the Negotiable Instruments Law, is performed will the law be made applicable.

These resolutions, are consistent with this author's theory that the Negotiable Instruments Law creates special objects and special persons to be subject to its operation. The fact that the physical world perceives the existence of negotiable instruments or of persons –with property rights to be protected by laws such as the Civil Code– will not automatically make them "special" objects or persons in the context of the Negotiable Instruments Law; other legal prerequisites must be met.[63]

XII. CONCLUSION

The notion of negotiable instruments emerged at a time when trading was drastically moving from the old to a new phase. It was created as a solution for merchants who wanted to temper the disadvantages of being prey to thieves in the course of their business and losing large amounts of money.

Although both money and a negotiable instrument were primarily created for transferring values of wealth, the negotiable character of a negotiable instrument should not only be considered in terms of physical transfer but also in terms of the rights of the characters –a holder in due course; a holder not in due course; and a person other than a holder, or a holder of an instrument without proper negotiation.

Thus, the concept of negotiability should not be limited to the status of a transferee taking a negotiable instrument, and if he were a subsequent owner or holder in due course, having more rights than the previous

63. *See generally*, Jose Marlon P. Pabiton, *Utilizing an Integrative Analytical Framework to Extract Negotiable Instruments Law Principles*, 48 ATENEO L. J. 248 (2003). The author tries to show his theory, that ordinary dealings between individuals in society are regulated by ordinary substantive and remedial laws. But these ordinary substantive laws recognize that when rights and obligations are sourced from special laws, then such special laws take precedence. The author further shows that such methodology has not been usually applied in resolving Negotiable Instrument Law disputes. More often than not, the special laws provide their own procedures to enforce rights an obligations arising from such special laws.

transferor. Defining the concept of negotiability in such a manner would be inadequate since negotiability not only talks of conferred rights on the subsequent holders. It means more than that. The term should be a representation of concepts that answer the questions: (1) Was there proper indorsement? (2) What was the intention of the transferor in indorsing? (3) What kind of subsequent holder did the negotiation create; a holder in due course, a holder not in due course, or a holder of an instrument without proper negotiation? It is only when these questions are answered that one can begin to appreciate the essence of the "negotiable" character of a negotiable instrument.

Some professors say that the Negotiable Instruments Law is passé. The Philippine Clearing House Rules even alter the movement of the negotiable instruments as originally contemplated by the law.

Does this mean that the Negotiable Instruments Law could not cope with speed of modernization?

This writer believes otherwise. History would show that, said law saved commerce at a time when trade was in its crudest forms; the law was even passed on from generation to generation. Rather, this author believes that the students of the law are the ones who have been rattled by the speed of modernization; these individuals, along with the general population, see the speed of communication and trade, and would like to beat the time. Even the judiciary and the executive branches of government seem to be rattled by the pace of modern life. They seem to resolve disputes that although look new, but are mere variations of old concepts, by using "new" solutions. In the process, the lessons taught by the past as recorded in history, and the manifestations of effective response, such as those written in "old" laws, are forgotten.

Soon, when the general population become used to the pace of the modern times, and seek a moment of silent contemplation, they will be placed in a situation similar to that of the early merchants (the merchants realized the problem, and so they created the Negotiable Instruments Law device); they will see the root of today's trading problems. But in creating a solution, the modern trading community need not endeavor to imagine or create a magical panacea. The principles to solve human problems have been thought of, but are only expressed in antiquated-looking forms like the Negotiable Instruments Law and the Civil Code. All that is needed is for the students of the law to extract such principles and propose that they be repackaged. This Note has been done with the hope that when such a realization comes, the solutions that have effectively deciphered the principles of commercial life have been extracted from the antiquated-looking solutions.