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# Recent Developments: Hand v. Mfrs. & Traders Trust Co.: A Holder in Due Course of a Promissory Note Is Not Subject to a Statutory Illegality Defense Unless the Statute Voids the Specific Transaction

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## RECENT DEVELOPMENT

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### ***HAND V. MFRS. & TRADERS TRUST CO.: A HOLDER IN DUE COURSE OF A PROMISSORY NOTE IS NOT SUBJECT TO A STATUTORY ILLEGALITY DEFENSE UNLESS THE STATUTE VOIDS THE SPECIFIC TRANSACTION.***

**By: David Coppersmith**

The Court of Appeals of Maryland held that a holder in due course of a promissory note is not subject to an illegality defense based on the violation of a statute, unless the statute voids the specific transaction. *Hand v. Mfrs. & Traders Trust Co.*, 405 Md. 375, 952 A.2d 240 (2008). The court further held that a guardian has legal capacity to sue, be sued, and execute promissory notes that encumber a property belonging to a ward. *Hand*, 405 Md. at 410-11, 952 A.2d at 261.

In the District of Columbia, Cordelia Smith (“Cordelia”) was appointed guardian of the property of her son, Clifton Smith (“Clifton”), both of whom resided in the District of Columbia at the time. Clifton settled a medical malpractice claim with a provision for the purchase of a house in Maryland. While residing in Maryland, Cordelia executed a promissory note, using the property of Clifton’s estate as collateral security for repayment of a personal loan. Cordelia refinanced the personal loan, again encumbering the guardianship property, without first obtaining required statutory approval from the District of Columbia court. Manufacturers & Traders Trust Company (“M&T”) succeeded to the interest in the second promissory note, which ultimately came into arrears. Cordelia petitioned the District of Columbia court to be removed as Clifton’s guardian. Patrick Hand (“Hand”) was appointed Clifton’s successor guardian.

M&T sued Hand, Cordelia, and Clifton in the Circuit Court for Prince George’s County for default in payment. The trial court found that M&T qualified as a holder in due course and awarded M&T a money judgment against the Guardianship and Cordelia in her individual capacity. Hand appealed to the Court of Special Appeals of Maryland, which affirmed the trial court, holding that M&T conducted an appropriate due diligence investigation which did not raise concerns about Cordelia’s authority to sign as guardian. The

Guardianship petitioned the Court of Appeals of Maryland for a writ of certiorari, which was granted.

The Guardianship's defenses were based on Section 3-305(a)(1) of the Commercial Law Article of the Maryland Code, which states that the right to enforce the obligation of a party to pay an instrument is subject to the defenses of lack of legal capacity and illegality of the transaction. *Hand*, 405 Md. at 391-92, 952 A.2d at 250 (citing MD. CODE ANN., COM. LAW § 3-305(a)(1) (West 2002)). The Guardianship contended that Cordelia lacked the legal capacity to sign the bill obligatory under the District of Columbia Code section 21-157, which requires court approval before a guardian can encumber the property of a ward; therefore, the transaction was illegal. *Hand*, 405 Md. at 381-83, 952 A.2d at 243-44 (citing D.C. CODE § 21-157 (2001)).

The Court of Appeals of Maryland held that a guardian, such as Cordelia, has the legal capacity to enter into transactions that encumber the ward's property. *Hand*, 405 Md. at 399-400, 952 A.2d at 254. The court explained that a lack of legal capacity relates to the legal ability to maintain legal proceedings. *Id.* at 394-95, 952 A.2d at 251-52 (citing *United States v. Poe*, 120 Md. 89, 87 A. 933 (1913)). Incapacity to sue exists when there is some legal disability, such as infancy, lunacy, or want of title in the plaintiff to the character in which he sues. *Hand*, 405 Md. at 397-98, 952 A.2d at 253 (quoting *Ohlstein v. Hillcrest Paper Co.*, 195 N.Y.S.2d 920 (1959)). The court found that Cordelia was neither incompetent nor incapacitated at the time she entered into the transactions at issue. *Hand*, 405 Md. at 399, 952 A.2d at 254. Additionally, the court determined that there was no want of title to Cordelia's character when she was Clifton's guardian because she was properly appointed guardian by the District of Columbia court. *Id.* at 398, 952 A.2d at 253.

The court then addressed the District of Columbia statute that requires court approval prior to encumbering guardianship property. *Id.* at 382, 952 A.2d at 244. The court noted that Maryland has no comparable court approval requirement to that of the District of Columbia. *Id.* When the note was executed and the misuse of the money occurred, all parties were residents of, and the collateral security was situated in, Maryland. *Id.* at 409, 952 A.2d at 260. Under Maryland law, if a court limits a guardian's authority, the letter appointing the guardian — usually a court order — must contain the limitation. *Id.* at 388, 952 A.2d at 248 (quoting MD. CODE ANN., EST. & TRUSTS § 13-215 (West 2001)). The court pointed out that the District of Columbia court order appointing Cordelia as guardian did not contain any express limitation on her power. *Hand*, 405 Md. at 388, 952 A.2d at 248. The court explained that unless a creditor has

actual knowledge of the limitation contained in the appointment letter, the creditor is protected as if the guardian had properly exercised her power. *Id.* at 389, 952 A.2d at 248 (quoting MD. CODE ANN., EST. & TRUSTS § 13-219 (West 2001)).

The dissent opined that Cordelia lacked the legal capacity to bind the guardianship. *Hand*, 405 Md. at 411, 952 A.2d at 261 (Harrell, J., dissenting). The dissent posited that the majority too narrowly limited the meaning of legal capacity to legal status. *Id.* at 412, 952 A.2d at 262. A guardian may lack legal capacity to act if an action taken is outside her authority. *Id.* at 413, 952 A.2d at 262.

The Court of Appeals of Maryland also held that an alleged illegality based upon the violation of a statute does not subject a holder in due course to the defense of illegality unless the statute, in express language, voids the specific transaction. *Hand*, 405 Md. at 411, 952 A.2d at 261. The court found that M&T qualified as a holder in due course because M&T was a holder of an instrument who took it (1) for value; (2) in good faith; (3) without notice that it contained an unauthorized signature; and (4) without notice that any of the parties had a defense described in section 3-305(a). *Id.* at 391, 952 A.2d at 249-50 (citing MD. CODE ANN., COM. LAW § 3-302 (West 2002)). Furthermore, the court found no express statutory language applicable to this situation. *Hand*, 405 Md. at 411, 952 A.2d at 261.

The court determined that an alleged infirmity must actually be a void transaction to be “illegal” in the context of applying as a valid defense by makers of the notes in holder in due course transactions. *Id.* at 403, 952 A.2d at 256-57. If an obligation is merely voidable, rather than void, at the election of the obligor, the defense of illegality is not available. *Id.* at 404, 952 A.2d at 257 (quoting *Kedzie & 103rd Currency Exch., Inc. v. Hodge*, 619 N.E.2d 732 (Ill. 1993)). Finally, the court explained that while Maryland law prohibits a guardian from using promissory note proceeds to benefit herself, the law does not require a holder in due course to monitor a guardian to ensure proper expenditure of loaned funds. *Hand*, 405 Md. at 408-09, 952 A.2d at 260.

The Court of Appeals of Maryland’s decision provides a narrow definition of legal capacity under Section 3-305(a)(1), limiting it to legal ability and excluding lack of authority. By holding that guardians may execute promissory notes that encumber a ward’s property, the court allows guardians wide latitude in what they may do with a ward’s property. If a guardianship is to be limited in what it may do with guardianship property, the court must include the limitation in the letter of appointment, giving a holder in due course notice of the limitation.