

Commercial and Consumer Credit Law—First Circuit Properly Construes Holder in Due Course Doctrine Under Massachusetts Law—*Jelmoli Holding, Inc. v. Raymond James Financial Services, Inc.*, 470 F.3d 14 (1st Cir. 2006)

Under Massachusetts law, a holder in due course takes a negotiable instrument free from the claims of others; however, when the taker obtains the instrument with notice of another's claim to the instrument, notice will negate the taker's holder in due course defense.¹ Notice of a fiduciary breach concerning the instrument is notice of a claim, so that a person who takes the instrument from a payor with notice of the payor's fiduciary breach to another is not a holder in due course.² In *Jelmoli Holding, Inc. v. Raymond James Financial Services, Inc.*,³ the First Circuit Court of Appeals considered whether, under Massachusetts law, a plaintiff may negate a holder in due course defense when the defendant had no actual knowledge that the person presenting the instrument was a fiduciary.⁴ The First Circuit held, pursuant to the General Laws of Massachusetts, that a plaintiff must demonstrate that a defendant had actual knowledge of a fiduciary's status, in addition to notice of the fiduciary's underlying breach of duty.⁵

Since 1990, William Potts worked for Jelmoli Holding, Inc. (Jelmoli), a Massachusetts company with a parent corporation headquartered overseas.⁶ Jelmoli permitted Potts to conduct a significant portion of its United States business, which included endorsing checks and verifying the proper maintenance of Jelmoli's United States accounts.⁷ In addition to working for Jelmoli, Potts operated an individual brokerage account with the defendant, the

1. See MASS. GEN. LAWS. ch. 106, § 3-302 (1999) (defining "holder in due course"); *id.* § 3-306 (codifying holder in due course defense). Normally, a person taking a negotiable instrument takes it subject to the claims of others. See *id.* § 3-306.

2. See MASS. GEN. LAWS. ch. 106, § 3-302 (1999) (requiring holder in due course to take instrument without notice of claim); *id.* § 3-307 (stating notice of breach of fiduciary duty equals notice of claim of represented person). A "represented person" is the "principal, beneficiary, partnership, corporation, or other person to whom the duty . . . is owed." *Id.* § 3-307(a)(2). A "fiduciary" is "an agent, trustee, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an instrument." *Id.* § 3-307(a)(1).

3. 470 F.3d 14 (1st Cir. 2006).

4. *Id.* at 18-19 (considering whether taker can have notice of claim without having actual knowledge of fiduciary status). The plaintiff asserted that it had properly vitiated the defendant's holder in due course defense by showing that the defendant had notice of the fiduciary's breach of duty, through which the defendant had received a negotiable instrument. *Id.* at 16-17 (describing plaintiff's allegations asserted at trial).

5. *Id.* at 19 (holding "knowledge of fiduciary status is a requirement for notice of the claim" under section 3-307).

6. *Id.* at 16 (explaining circumstances surrounding Potts's employment with Jelmoli based in Switzerland).

7. 470 F.3d at 16 (recounting Potts's responsibilities as Jelmoli employee).

Raymond James brokerage firm.⁸

In the stock market collapse of 2000, the value of Potts's personal account declined significantly.⁹ Raymond James permitted Potts to trade on the margin, paying only a percentage of the stock price and borrowing the balance from Raymond James; accordingly, following the market collapse, Potts was unable to cover the necessary margin between stock value and balance owed.¹⁰ In April 2000, to maintain his margin account, Potts drew checks from a Jelmoli bank account and transferred the proceeds to Raymond James.¹¹ In response to Raymond James's inquiry regarding the Jelmoli checks, Potts stated that he owned Jelmoli and could use the checks as he desired.¹² Between April and December 2000, Potts provided Raymond James with Jelmoli checks totaling \$1.5 million to maintain his personal brokerage account.¹³

In December 2000, Potts revealed to Jelmoli that he had embezzled funds from its United States bank account to pay for his failing brokerage account with Raymond James.¹⁴ In response, Jelmoli sued Raymond James in the federal district court in Massachusetts to recover \$1.3 million of the funds Potts fraudulently transferred to Raymond James.¹⁵ At trial, Raymond James argued that it was a statutory holder in due course and, therefore, immune from liability to Jelmoli.¹⁶ The district court judge instructed the jury that Jelmoli could defeat Raymond James's holder in due course defense by showing that Raymond James had known of the facts and circumstances that gave it reason to know a claim existed.¹⁷ Following the instructions, the jury determined that

8. *Id.* (noting Potts's brokerage activities with Raymond James).

9. *Id.* (discussing decline in Potts's investments at Raymond James).

10. *Id.* (observing Potts's financial difficulties with Raymond James).

11. 470 F.3d at 16 (discussing Potts's use of Jelmoli funds to maintain his brokerage account).

12. *Id.* (describing Potts's explanation for use of Jelmoli checks provided to Raymond James).

13. *Id.* (detailing amount of Jelmoli funds transferred to Raymond James by Potts).

14. *Id.* (discussing Potts's embezzlement confession to Jelmoli).

15. 470 F.3d at 16 (noting Jelmoli's lawsuit against Raymond James). Jelmoli advanced two theories of recovery at trial. *Id.* at 16-17. First, Jelmoli argued that Raymond James had "money had and received." *Id.* at 17. Second, Jelmoli argued that Raymond James was unjustly enriched by Potts's fraudulent transfers. *Id.* at 17 & n.2 (discussing differences between "money had and received," and unjust enrichment theories). Jelmoli did not inform Raymond James about the embezzlement until months after the confession. *Id.* at 16. By the time Raymond James learned about the fraud, Potts had withdrawn all funds from his Raymond James brokerage account. *Id.*

16. *Id.* at 17 (discussing Raymond James's defense theory at trial).

17. *Id.* at 18 (recounting judge's instructions characterizing requirement of knowledge of fiduciary status as "special rule"). Raymond James objected to the jury instruction because it did not properly limit Jelmoli's ability to overcome Raymond James's holder in due course defense. *See id.* Despite this objection Judge Lindsay stated:

Next, the defendants must prove by a preponderance of the evidence that they did not have notice of Jelmoli's claim to each of the checks. In this context, the defendants had notice of Jelmoli's claim if they had actual knowledge of the claim or if the defendants had received notice or notification of the claim or if from all the facts and circumstances known to the defendants at the time in question they had reason to know that the claim existed Now, special rules apply if the defendants as to any

Raymond James was a valid holder in due course for only some of the checks but was still liable to Jelmoli for \$1.1 million.¹⁸ On appeal, the First Circuit agreed with Raymond James's position that the district court erred by failing to instruct the jury that Raymond James could have notice of Jelmoli's claim to the embezzled funds, thereby negating Raymond James's holder in due course defense, only if Raymond James had actual knowledge of Potts's fiduciary status.¹⁹

In 1951, the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL) composed the original draft of the Uniform Commercial Code (UCC), making it available for the states to ratify.²⁰ Within this first draft, Article 3 governed the law of drafts, checks, and promissory notes.²¹ In 1985, in an age where people began to conduct fewer face-to-face transactions, the ALI and NCCUSL responded to the need to modernize Article 3's governance of negotiable instruments by considering broad changes to Article 3.²² In particular, the ALI and NCCUSL sought to

Jelmoli check they received had actual knowledge of the fiduciary status of Potts. If the defendants had actual knowledge of the fiduciary status of Potts, they had notice of his breach of that fiduciary duty and notice of Jelmoli's claim to that check if they, one, took the check in payment of or as security for a debt known by the defendants to be the personal debt of Potts; or, two, took that check in a transaction known by the defendants to be for the personal benefits of Potts; or, three, deposited the check to an account other than an account of Jelmoli or an account of Potts as fiduciary of Jelmoli.

Id.

18. *Id.* at 17 (noting jury decision).

19. 470 F.3d at 18 (discussing Raymond James's appeal). Raymond James also asserted that the faulty instruction required the appeals court to grant a new trial to determine the proper amount of liability owed to Jelmoli. *Id.* Raymond James's appeal directly addresses the question of whether a plaintiff may only defeat a defendant's holder in due course defense involving a fiduciary breach under section 3-307. *See id.* If so, a plaintiff would have to show, among other factors, that a defendant had "knowledge of the fiduciary status of the fiduciary," as well as "notice of the breach of fiduciary duty." *See* MASS. GEN. LAWS. ch. 106, § 3-307(b)(ii) (1999) (requiring *knowledge* of fiduciary status); *id.* § 3-307(b)(4) (requiring *notice* of fiduciary breach). Conversely, Jelmoli asserted on appeal that a plaintiff may defeat a holder in due course defense merely by proving "notice" of fiduciary status. 470 F.3d at 18; *see also* MASS. GEN. LAWS. ch. 106, § 3-302 (1999) (requiring notice, not knowledge, to defeat holder in due course defense). Under Jelmoli's interpretation, a plaintiff would have the option of overcoming a holder in due course defense, in the specific context of a fiduciary breach, under either section 3-302 or section 3-307. 470 F.3d at 18; *see also* HERBERT LEMELMAN, MANUAL ON UNIFORM COMMERCIAL CODE, 25 MASS. PRACTICE SERIES § 3:134 (3d ed. 2006) (explaining Jelmoli's position relied on section 3-302's general definition of notice in context of fiduciary breach).

20. *See* PERMANENT EDITORIAL BOARD, REPORT NO. 1 OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE 7 (1962) (outlining history of Uniform Commercial Code); Donald W. Garland, *A New Law of Negotiable Instruments: Revised Article 3 of the UCC*, 109 BANKING L.J. 557, 557-58 (1992) (discussing history of UCC Article 3).

21. *See* Garland, *supra* note 20, at 557-58 (detailing role of Article 3 in 1951 UCC draft). The UCC authors based Article 3 on a revision of the Uniform Negotiable Instruments Law, which closely mirrored the British Bill of Exchange Act of 1882, which codified English common law from the eighteenth and nineteenth centuries. *Id.*

22. *See* Garland, *supra* note 20, at 557-58 (discussing amendment of Article 3); Michael D. Sabbath, *UCC Update: Revised Articles 3 and 4*, 48 MERCER L. REV. 83, 83 (1996) (discussing comprehensive

“replace archaic terminology, make Article 3 more relevant to today’s business transactions, and to recognize that notes and drafts have different functions so as to merit different treatments.”²³ On January 24, 1991, the revised version of Article 3 (revised UCC) became available for ratification.²⁴

Under the original UCC, the rules governing notice of fiduciary breach were difficult to interpret and scattered among various code sections.²⁵ A new provision within section 3-307 of the revised UCC consolidated these various sections and clarified that a taker’s notice of a fiduciary’s breach of duty, concerning the fiduciary’s transfer of a negotiable instrument to the taker, vitiates the defendant-taker’s status as a holder in due course.²⁶ Under revised UCC section 3-307, “[n]otice of breach of fiduciary duty by the fiduciary is notice of the claim of the represented person.”²⁷ Within this framework, subsection 3-307(b)(4) outlines three specific instances in which a defendant obtains notice of a fiduciary’s breach, thereby negating a defendant’s holder in due course defense under revised UCC section 3-302.²⁸ To defeat a holder in

modifications to UCC Article 3).

23. AMERICAN LAW INSTITUTE, UNIFORM COMMERCIAL CODE CURRENT PAYMENT METHODS PROJECT, PROGRESS REPORT 4 (1988) (noting objectives of Article 3 redraft).

24. See Garland, *supra* note 20, at 558 (discussing release of revised UCC Article 3). Less than two years after the National Conference of Commissioners on Uniform State Laws and the American Law Institute’s release of revised Article 3, fifteen states enacted the new section, and another fourteen states considered enactment. *Id.* (discussing states’ rapid reaction to release of revised Article 3).

25. See Garland, *supra* note 20, at 565-66 (noting confusion surrounding notice of fiduciary breach under original UCC Article 3). The UCC set forth notice of fiduciary breach as notice of a claim under the holder in due course doctrine in several different sections of the code. See *id.*; see also LEMELMAN, *supra* note 19, § 3:134 (discussing former UCC sections governing breach of fiduciary duty as notice).

26. See U.C.C. § 3-307 (1995) (addressing notice and breach of fiduciary duty in holder in due course defense context); *id.* § 3-302 (outlining holder in due course defense).

27. U.C.C. § 3-307(b)(1) (1995) (discussing relationship between notice of fiduciary breach and notice of represented person’s claim). A plaintiff, however, may only impute notice of a represented person’s claim to an instrument through a fiduciary’s breach of duty when the following three factual elements exist:

- (i) an instrument is taken from a fiduciary for payment or collection or for value, (ii) the taker has knowledge of the fiduciary status of the fiduciary, and (iii) the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty.

Id. § 3-307(b). Theoretically, therefore, a plaintiff must first satisfy these three requirements before attempting to defeat a defendant’s holder in due course defense under the subsections of 3-307. See *id.*

28. See U.C.C. § 3-307(b)(4)(i)-(iii) (1995) (providing distinct instances when defendant obtains notice of fiduciary breach). Section 3-307(b)(4) provides:

If an instrument is issued by the represented person or the fiduciary as such, to the taker as payee, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

Id. § 3-307(b)(4).

due course defense, therefore, a plaintiff must satisfy one of the three subsection 3-307(b)(4) prongs, in addition to showing that the defendant had knowledge of the fiduciary's relationship to the plaintiff.²⁹

In 1998, Massachusetts adopted an identical version of revised UCC section 3-307.³⁰ Until recently, Massachusetts courts had not addressed the significance of this revision.³¹ Several state and federal courts, however, determined that revised UCC section 3-307 requires plaintiffs to prove that a defendant had knowledge of a fiduciary's relationship to the plaintiff, as well as notice of the fiduciary's breach in tendering a negotiable instrument to the defendant.³²

In *Jelmoli Holding, Inc.*, the First Circuit decided that Massachusetts law requires a plaintiff to show that a defendant had both notice of the fiduciary's breach of duty to the plaintiff, as well as knowledge of the fiduciary's relationship to the plaintiff, to defeat a holder in due course defense.³³ The

29. See U.C.C. § 3-307(b) (1995) (conditioning application of section 3-307(b)(4) on taker's knowledge of fiduciary's status); LEMELMAN, *supra* note 19, § 3:134 (explaining knowledge of both fiduciary status and substantive events prerequisites to notice of fiduciary breach).

30. See Act of February 12, 1998, 1998 Mass. Adv. Legis. Serv. 24, at *8 (LexisNexis) (codified as amended at MASS. GEN. LAWS. ch. 106, § 3-307 (1999)) (amending Massachusetts laws according to revised UCC).

31. See MASS. GEN. LAWS. ch. 106, § 3-307 (1999) (lacking case annotations concerning amended law). Although the courts had not addressed section 3-307, the Supreme Judicial Court held, in the context of chapter 106, section 8-302 of the General Laws of Massachusetts, that only actual knowledge of an adverse claim will defeat the bona fide purchaser status in the context of a fiduciary breach. See *Demoulas v. Demoulas*, 703 N.E.2d 1149, 1165 (Mass. 1998) (holding mere notice of fiduciary status does not create duty of inquiry). Surprisingly, the most recent Massachusetts case to specifically address the issue of notice of fiduciary status and breach, in the context of the holder in due course defense, occurred in 1906. See *Fillebrown v. Haywood*, 77 N.E. 45, 47 (Mass. 1906) (analyzing common law holder in due course defense).

32. See, e.g., *Mut. Serv. Cas. Ins. Co. v. Elizabeth State Bank*, 265 F.3d 601, 621 (7th Cir. 2001) (holding Illinois law requires plaintiff to show knowledge of fiduciary status and breach of duty); *Broadview Lumber Co. v. Sw. Mo. Bank of Carthage*, 118 F.3d 1246, 1252 (8th Cir. 1997) (deciding holder in due course proper when defendant takes without knowledge of fiduciary status or breach); *Conder v. Union Planters Bank, N.A.*, No. IP 01-0086-C-T/K, 2002 WL 31431566, at *2 (S.D. Ind. Sept. 27, 2002) (finding defendant's knowledge of fiduciary status defeated holder in due course defense under Indiana law); *Grand Rapids Auto Sales, Inc. v. MBNA Am. Bank*, 227 F. Supp. 2d 721, 729 (W.D. Mich. 2002) (upholding defense under Michigan law when defendant had no knowledge of payor's fiduciary relationship to plaintiff); *Cable Cast Magazine v. Premier Bank, N.A.*, 729 So. 2d 1165, 1168 (La. Ct. App. 1999) (noting defendant lacked actual knowledge of fiduciary's status when fiduciary claimed ownership of company); *United Catholic Parish Sch. of Beaver Dam Educ. Ass'n v. Card Servs. Ctr.*, 636 N.W.2d 206, 212 (Wis. Ct. App. 2001) (holding Wisconsin section 3-307 statute applicable only when plaintiff shows defendant's knowledge of fiduciary's status); *cf. Progressive Cas. Ins. Co. v. PNC Bank, N.A.*, No. Civ.A. 98-6840, 1999 WL 557292, at *3 (W.D. Pa. July 26, 1999) (holding knowledge of deposit into fiduciary's personal account represents notice of fiduciary breach); *In re The Villas at Hacienda Del Sol, Inc.*, No. 4-05-BK-1482-EWH, 2006 WL 3449150, at *1 (Bankr. D. Ariz. Nov. 27, 2006) (upholding defense when plaintiff failed to prove defendant had notice of fiduciary breach). *But see Citibank Texas, N.A. v. Progressive Cas. Ins. Co.*, No. 3:06-CV-0395-H, 2006 WL 3751301, at *4 (N.D. Tex. Dec. 21, 2006) (failing to require plaintiff to show defendant's knowledge of fiduciary status), *aff'd*, 508 F.3d 779 (5th Cir. 2007).

33. 470 F.3d at 19 (holding knowledge of fiduciary status also necessary to vitiate holder in due course defense); see also *supra* note 1 and accompanying text (noting Massachusetts statutory "holder in due course" doctrine). Therefore, the court concluded that the district court judge erred when he instructed the jury that

court rejected the plaintiff's argument to negate the defendant's holder in due course status by showing that the defendant had notice of a fiduciary breach without also proving that the defendant had knowledge of the fiduciary's status.³⁴ Instead, the court adopted Raymond James's position at trial that when a claim involves a breach of fiduciary duty, a plaintiff may only establish notice of that claim pursuant to section 3-307.³⁵ Looking to the NCCUSL and ALI commentary accompanying section 3-307, as well as the specific purpose of the holder in due course defense, the court reasoned that section 3-307 "carves out narrow exceptions" to the general notice doctrine present in 3-302.³⁶ As such, the court held that inquiry notice is insufficient to defeat holder in due course status because "[t]he plaintiff must also show knowledge by the taker, and not just warning clues, that the person tendering the check is a fiduciary."³⁷

The appeals court correctly held that a plaintiff must show both notice of a fiduciary breach, as well as knowledge of the fiduciary's relationship, to defeat a holder in due course defense.³⁸ Although section 3-302 permits a taker's notice of a claim to overcome a holder in due course defense, the court properly recognized that the NCCUSL and ALI sought to limit section 3-307's application to "uncommon" cases where the defendant-taker knows of the

Jelmoli could show that Raymond James had notice of the plaintiff's claim merely by showing that Raymond James had notice of a fiduciary breach. 470 F.3d at 19. The court held that although Jelmoli showed notice of Potts's fiduciary breach, in addition to other requirements under section 3-307(b)(4), Jelmoli failed to satisfy the initial requirement of proving that Raymond James had *knowledge* of Potts's fiduciary status. *Id.*

34. 470 F.3d at 18 (questioning whether plaintiff may show notice under either sections 3-302 or 3-307). In doing so, the appeals court rejected the district court's instruction that a plaintiff may show notice as required under section 3-307(b) by essentially proving notice of a claim pursuant to section 3-302(a)(2). *See id.* The appeals court asserted that at retrial, the judge must instruct the jury that "knowledge of fiduciary status is a *requirement* for notice of the claim." *Id.* at 19 (emphasis added).

35. *See id.* at 18-19 (considering and adopting defendant's interpretation of statute). The court, however, acknowledged that the statute could be read either way. *See id.* at 19.

36. *Id.* at 18-20 (noting mere notice of fiduciary status insufficient to satisfy section 3-307). In supporting its decision, the court acknowledged that section 3-307's more stringent knowledge requirement "is meant to limit Section 3-307 to relatively uncommon cases in which the person who deals with the fiduciary knows all of the relevant facts." *Id.* at 19. As a result, "mere notice" of such relevant facts is not enough to satisfy section 3-307 and vitiate a holder in due course defense arising out of a breach of fiduciary duty. *Id.* Further, the court noted that this decision reflected the holder in due course's general purpose of "facilitat[ing] transactions and encourag[ing] the acceptance of negotiable interests." *Id.*; *see also* *Hawkland's Uniform Commercial Code Series*, 4 WILLIAM D. HAWKLAND & LARY LAWRENCE § 3-302:1 (West 1982 & Supp. 2006) (explaining strict requirements of holder in due course due to effect on innocent parties); 2 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 150 (4th ed. 1995) (discussing policy encouraging acceptance of checks in commercial transactions behind holder in due course doctrine). *But see* Gregory E. Maggs, *The Holder in Due Course Doctrine as a Default Rule*, 32 GA. L. REV. 783, 783-85 (1998) (questioning traditional policy arguments behind holder in due course defense).

37. *See* 470 F.3d at 19 (providing breach of fiduciary duty alone insufficient to negate holder in due course defense). Therefore, the appeals court granted Raymond James's motion for a new trial in part because the district court's jury instructions permitted Jelmoli to obviate section 3-307's knowledge requirement. *Id.*

38. *See id.* at 19 (announcing holding); *see also supra* note 1 (outlining statutory framework of holder in due course defense).

fiduciary's status and the breach of duty.³⁹ Recognizing section 3-307's limited application to "uncommon" circumstances, the court's decision effectuated the plain and rational meaning of the statute, which clearly requires both knowledge of fiduciary status as well as notice of fiduciary breach.⁴⁰

Additionally, the court's decision was congruent with the few cases addressing the same issue under state law identical to Massachusetts General Laws chapter 106, section 3-307.⁴¹ For example, the Seventh Circuit recognized, under Illinois Law, that a plaintiff must show that the defendant had knowledge of a fiduciary's status and must establish facts indicating a breach of fiduciary duty.⁴² Likewise, both the Eighth Circuit and the Western District of Michigan held that a holder in due course defense prevails when a defendant takes a negotiable instrument from fiduciaries without knowledge of their status.⁴³ Like the trial court's decision, however, the District Court for the Northern District of Texas also failed to specifically hold whether knowledge of fiduciary status is required under a state statute identical to section 3-307.⁴⁴

The First Circuit's decision also furthers the statute's purpose by requiring a more specific showing to vitiate a holder in due course defense when a fiduciary transfers a negotiable instrument to a defendant in violation of a duty

39. See MASS. GEN. LAWS. ch. 106, § 3-307, cmt. 1 (1999) (stating section 3-307 "comprehensively" covers notice of breach of fiduciary duty as notice of claim); 470 F.3d at 19 (noting comments to section 3-307). The appeals court noted that, in light of 3-307, section 3-302's ambiguity could forgo the plaintiff's need to show knowledge of fiduciary status to vitiate a defendant's holder in due course status. 470 F.3d at 19. Looking to comments 1 and 2, however, the court determined that "section 3-307 is meant exclusively to control where the claim is one of breach of fiduciary duty." *Id.* According to the court's reasoning, a plaintiff's attempt to defeat a defendant's holder in due course status under section 3-307 differs from that occurring under section 3-302. *Id.* For example, the court provided that section 3-307 would apply "where there is actual knowledge that one known to be a fiduciary is profiting—but mere inquiry notice of fiduciary status is not enough." *Id.*

40. See MASS. GEN. LAWS. ch. 106, § 3-307 (1999) (conditioning notice of fiduciary breach in delivery of negotiable instrument upon knowledge of fiduciary status); 470 F.3d at 18-19 (discussing limited circumstances allowing defeat of holder in due course defense). Section 3-307(b)(ii) asserts that a plaintiff must establish taker's "knowledge of the fiduciary status of the fiduciary" for the rule regarding notice of fiduciary breach to apply. MASS. GEN. LAWS. ch. 106, § 3-307(b)(ii). The language of section 3-307(b)(4), regarding notice of fiduciary breach is, therefore, clearly conditional upon the plaintiff providing evidence of the defendant's knowledge of the fiduciary's status. See *id.*

41. See *supra* note 32 (discussing interpretations of state law identical to section 3-307). The First Circuit's holding in *Jelmoli* is harmonious with each of these decisions. See *id.*; see also 470 F.3d at 19.

42. See *Mut. Serv. Cas. Co. v. Elizabeth State Bank*, 265 F.3d 601, 621 (7th Cir. 2001) (interpreting UCC section 3-307 and Comment 2). In similar fashion, the Southern District of Indiana held that a defendant-taker had notice of a claim when it had knowledge of a fiduciary's status and knowledge of the facts of the fiduciary's breach of duty. See *Conder v. Union Planters Bank, N.A.*, No. IP 01-0086-C-T/K, 2002 WL 31431566, at *2 (S.D. Ind. Sept. 27, 2002).

43. See *Broadview Lumber Co. v. Sw. Mo. Bank of Carthage*, 118 F.3d 1246, 1252 (8th Cir. 1997) (deciding holder in due course proper when defendant takes without knowledge of fiduciary status or breach); *Grand Rapids Auto Sales, Inc. v. MBNA Am. Bank*, 227 F. Supp. 2d 721, 729 (W.D. Mich. 2002) (upholding defense when defendant had no knowledge of payor's fiduciary relationship to plaintiff).

44. See *Citibank Texas, N.A. v. Progressive Cas. Ins. Co.*, No. 3:06-CV-0395-H, 2006 WL 3751301, at *4 (N.D. Tex. Dec. 21, 2006) (failing to require plaintiff to show defendant's knowledge of fiduciary status), *aff'd*, 508 F.3d 779 (5th Cir. 2007).

owed to its principle.⁴⁵ The decision properly effectuates the goal of the NCCUSL and ALI in drafting section 3-306 to facilitate commercial transactions by encouraging acceptance of negotiable instruments without fear of their invalidity.⁴⁶ Furthermore, the court properly held that section 3-307 did not overly burden Jelmoli by requiring Jelmoli to show both Raymond James's knowledge of Potts's fiduciary status and notice of Potts's fiduciary breach, because Jelmoli chose Potts as its fiduciary, and accordingly, Potts's conduct was Jelmoli's ultimate responsibility.⁴⁷

In *Jelmoli Holding, Inc. v. Raymond James Financial Services, Inc.*, the First Circuit determined whether, under Massachusetts law, a plaintiff must prove that a defendant knew of the embezzler's fiduciary status, as well as notice of the fiduciary's breach of duty, to vitiate a defendant's holder in due course defense. The court correctly held that chapter 106, section 3-307, of the General Laws of Massachusetts requires the plaintiff to show that defendant had knowledge of both the fiduciary's status as well as the fiduciary's breach to the plaintiff when tendering a negotiable instrument to the defendant. In doing so, the court properly interpreted the language and purpose of section 3-307, as well as the policy rationale supporting a more narrow interpretation of section 3-307, and ruled in accordance with other federal and state courts interpreting identical state law.

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45. See 470 F.3d at 19 (noting purpose of defense to facilitate transactions); see also *supra* note 36 (noting policy reasons behind enactment of section 3-307). The district court was concerned that interpreting section 3-307 to require knowledge rather than notice of fiduciary status would encourage defendants to ignore warning signs of a fiduciary's potential breach of duty. See 470 F.3d at 19. The First Circuit, however, rejected this assertion, stressing that inquiry notice is not the statutory test. See *id.*

46. See 470 F.3d at 19 (recognizing policy reasons behind decision); see also 4 HAWKLAND & LAWRENCE, *supra* note 36, § 3-302:1 (noting policy reasons behind holder in due course doctrine); 2 WHITE & SUMMERS, *supra* note 36, at 150 (discussing purpose of holder in due course defense); *supra* note 1 (discussing section 3-306).

47. See 470 F.3d at 19 (discussing plaintiff's relationship with fiduciary as justification for stringent interpretation of section 3-307); 6 HAWKLAND & LAWRENCE, *supra* note 36, § 3-307:5 [Rev] (observing fiduciary treated as represented person's responsibility because represented person chose fiduciary).