

## F E D E R A L   R E S E R V E   B O A R D

WASHINGTON

January 18, 1915.

Subject: Section 5200  
Revised Statutes.

My dear Governor:

In response to your verbal request, I have carefully examined and considered the provisions of Section 5200 of the Revised Statutes of the United States, with the view of reaching a conclusion as to its proper interpretation. The language upon which you desire an opinion is as follows:

"The total liabilities to any association, of any person ....., for money borrowed .....shall at no time exceed one-tenth part of the amount of the capital stock of such association.....and one-tenth part of its unimpaired surplus fund.....But the discount of bills of exchange drawn in good faith against actually existing values, and the discount of commercial or business paper actually owned by the person negotiating the same shall not be considered as money borrowed".

From this it appears that the person discounting bills of exchange or commercial paper of the kind described, with a national bank, may become liable to the bank as a result of such transaction but such liability, under the terms of the Act, shall not be classed as "money borrowed". This liability may assume one of two forms, that is to say, it may result -

- (a) from the discount of bills of exchange drawn in good faith against actually existing values, or
- (b) from the discount of commercial or business paper actually owned by the person negotiating the same.

While such bills of exchange, or commercial or business paper, should represent the same class of transactions in order to be included in the exception quoted, it is necessary to consider them separately on account of their difference in form.

Bills of Exchange.

In the case of bills of exchange drawn in good faith against actually existing values, the language "in good faith" is clearly intended to mean that the drawer must have the legal right to draw and that the bill of exchange must not be drawn merely with the hope or expectation that it will be paid.

The language "against actually existing values" is more vague and indefinite and less susceptible of clear interpretation. In reaching a conclusion as to its meaning we must consider the context of the Act in order to determine what class and character of transaction Congress had in contemplation. In doing so we find, as shown above, that the alternative form which such liability may assume is "commercial or business paper actually owned by the person negotiating the same". The term "commercial" as ordinarily used is defined to mean "pertaining to trade or commerce", that is to say, pertaining to buying and selling for money.

Considering this language, therefore, in its ordinary sense, it seems clear that Congress had in contemplation liabilities involved in the purchase and sale of commodities, and this view has been adopted and adhered to by the office of the Comptroller.

The question, therefore, arises whether "actually existing values" refers to the value of the commodity sold or can it be said to refer to the responsibility of the purchaser or drawee. The former view has been adopted by the office of the Comptroller as the more reasonable interpretation. This seems clearly justifiable (a) since it seems unlikely that Congress would have used the language "existing values" if it had intended to refer to the financial responsibility of an individual, firm or corporation, and (b) because the drawee against whom the bill is drawn is not legally bound to pay it until the bill is accepted. In other words, if the bill is excepted from the limitations of Section 5200 because the bank has recourse against some "existing values" and is not dependent solely upon the responsibility of the drawer or endorser who discounts it, the bank must be in a position to enforce its claim legally against whatever constitutes the "existing values" against which the bill is drawn and must, therefore, have a lien in some form evidenced by a bill of lading, warehouse receipt, or some other documentary evidence, for the commodity sold.

Commercial or Business Paper.

In the case of "commercial or business paper actually owned by the person negotiating the same", the transaction must, as indicated, also be based upon the sale of some commodity, but in this instance the liability is evidenced in a form possessing characteristics distinctly different from that of a bill of exchange or draft. In other words, a draft or bill of exchange is merely an order on the drawee to pay and the drawee, as stated, is not legally bound until he accepts it.

On the other hand, when the liability involved is evidenced by the note of the purchaser, the purchaser assumes the primary or direct liability to the holder of the note and the bank discounting such note as an innocent purchaser for value without notice, takes it free from any equities existing as between the seller and the purchaser. The seller, as the endorser of the note, assumes only an indirect or contingent liability to the bank, which has recourse legally against the maker. In this case, therefore, the bank is not dependent solely upon the value of the commodity sold or upon the financial responsibility of the person discounting the note.

When the liability in question assumes the form of commercial or business paper, therefore, while the transaction, as stated, must be one in which the sale of a commodity is involved, it would seem to be unnecessary for the note to be accompanied by a bill of lading or warehouse receipt constituting a lien on such commodity. The only qualification contained in the statute in such case is that such "commercial or business paper" shall be actually owned by the person negotiating the same. In other words, there must have been an actual bona fide sale, and the debt due from the purchaser to the seller must actually exist when such "commercial or business paper" is discounted.

It has been contended that the sale of a commodity is not necessary in either case, on the ground that if the drawer of the bill of exchange has furnished money to the drawee, instead of selling the commodity, or if the payee of a note has made a loan to the maker, instead of making such sale, in either case, the drawer or the payee has furnished "existing values" and the draft or note, therefore, meets the requirements of the statute. There is, however, a distinction between a loan of money and the sale of a commodity. If a loan is made to a third party, evidenced by a note, it must be assumed that the proceeds of such loan are to be used for some purpose other than the payment of the

note, since otherwise there would have been no occasion for the loan. In like manner, if the drawer of a bill of exchange furnishes funds to the drawee in advance, it must be assumed that such funds are to be used for some other purpose than the payment of the draft. Where commodities, however, are sold to the drawee or to the maker of the note, it is to be assumed that the drawee or maker intends to re-sell such commodities and to pay the draft or note with the proceeds.

#### Acceptances.

From the foregoing it will appear that where a bill of exchange drawn for the purchase price of a commodity sold, has been accepted by the purchaser or the drawee, it possesses the same characteristics as other commercial or business paper. That is to say, the purchaser thereupon assumes the direct or primary liability to the holder. The bank has recourse legally against the acceptor and holds the drawer and endorsers contingently liable in case the acceptor fails to pay such bill of exchange at maturity. In such case the acceptance, if actually owned by the person negotiating it, would seem to come within the broader language of "commercial or business paper actually owned by the person negotiating the same", and so need not be accompanied by a bill of lading, warehouse receipt, or other documentary evidence constituting a lien on the commodity sold.

#### Accommodation Paper.

If the bill of exchange is drawn merely on a promise on the part of the drawee to pay, or if the note is made merely to enable the holder to borrow money from the bank, such paper is in all respects accommodation paper, and while it may be said to conform in such case to the provisions of the Act, in so far as the form of liability is concerned, it lacks the elements necessary to remove it from the limitations imposed by Section 5200.

#### Finance or Investment Bills and Notes.

In like manner, if money is furnished merely for investment purposes, or for any purpose except to enable the purchaser to pay the seller for commodities purchased, the transaction could not be said to come within the exceptions to the limitations of Section 5200.

#### Court Decisions.

I have discussed at some length the various questions involved in the interpretation of this Act, in order

to explain the reasons for the conclusions reached. There has been a considerable diversity of opinion as to the meaning of the language used, and so far as I have been able to learn, there has been no judicial construction of this Act by the United States courts which will assist in reaching a conclusion as to its meaning.

In a number of cases, where suit has been brought by national banks, the defense has been set up that loans made by such banks were in excess of the limitations of Section 5200 and, therefore, ultra vires. In such cases the courts have held that this does not invalidate the loan nor constitute a defense but is a matter merely of regulation. Accordingly, they have not construed the language in question but have held, in effect, that this question can best be raised in a suit to forfeit the charter of a national bank brought by the Comptroller of the Currency under authority of Section 5239 of the Revised Statutes. As no such suit has ever been instituted by the Comptroller, this question has not been judicially determined by the United States courts.

The question was considered, however, in the case of The Second National Bank of Oswego vs. Burt, 93 N. Y. 233, when in construing the proviso in Section 5200 which reads, "But the discount of bills of exchange drawn in good faith against actually existing values, and the discount of commercial or business paper actually owned by the person negotiating the same, shall not be considered as money borrowed", the Court said:

"We think it entirely immaterial whether such bills are accompanied by a specific bill of lading in each case, or are drawn against property previously consigned, and existing either in its original form or in the shape of proceeds of sales in the hands of the consignees. In either case the funds have already been provided by the drawer in the hands of the drawees to meet the requirements of the obligation.

"The object of this provision of the Currency Act was to guard national banks from the hazard of loaning money in improvident amounts upon speculative and accommodation paper, but it contemplated and permitted to an unlimited amount the discount of paper used and required in facilitating the transfer of property and money in the transaction of the legitimate business of the country."

C. S. H. No. 6.

In this case the firm of Page & Company had drawn a bill of exchange against White & Company, another firm composed of the same members, who were the regular consignees for Page & Company in the sale of lumber. While the bill of lading did not accompany the bill of exchange, it appears that White & Company accepted the bill of exchange before it was discounted and so the bank had recourse against the drawee legally. The views herein expressed are therefore in accord with the decision of the court in this case, which appears to be the only reported decision of any court of competent jurisdiction dealing directly with this subject.

Summary of Conclusions.

To summarize the conclusions reached, I am of the opinion that any liabilities to a national bank contracted by any person, firm or corporation, are subject to the limitations of Section 5200, except -

(a) Liabilities evidenced by a bill of exchange drawn by the seller of some commodity against the purchaser and secured by bill of lading, warehouse receipt, or other documentary evidence giving the bank a lien on or recourse against the commodity in question.

(b) Liabilities evidenced by accepted bills of exchange drawn for the purchase price of commodities sold, such acceptances being actually owned by the person negotiating same.

(c) Liabilities evidenced by a note executed by the purchaser of a commodity for the whole or part of the purchase price, endorsed by the seller and discounted by the seller or actual owner of such note.

Respectfully,

(Signed) M. C. ELLIOTT

Counsel.

Honorable C. S. Hamlin,  
G o v e r n o r .

1/20/15