144 a.

February 2, 1915.

SUBJECT: Conditions attached to bills of exchange and acceptances affecting negotiability.

My dear Governor:

I have the honor to acknowledge receipt of your request for an opinion on the subject of conditions attached to bills of exchange and acceptances which affect their negotiability.

It is somewhat difficult to define in specific terms what conditions may or may not be prescribed in a bill of exchange without affecting the negotiability of such bill since the negotiable instruments laws of all the states are not identical and the decisions of the various courts are by no means uniform on this subject.

As I understand it, the Board has under consideration the question of prescribing a method by which bills of exchange or acceptances dealt in by member banks or Federal reserve banks may show that such bills or acceptances grow out of transactions involving the exportation or importation of goods without affecting their negotiability, and it is primarily upon this question that you desire an opinion.

In dealing with this subject, it is important to keep in mind the distinctive difference between a bill of exchange and an acceptance, and also the difference in status between an acceptor and a drawer of a bill.

Section 126 of the negotiable instruments law adopted by forty-one states and the District of Columbia, defines a bill of exchange as an

> "Unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer".

Section 127 states that -.

"A bill of itself does not operate as an assignment of the funds in the hands of the drawee available for the payment thereof, and the drawee is not liable on the bill unless and until he accepts the same".

Until the bill is accepted, therefore, the drawer is primarily liable and the bank discounting such bill can have recourse only against the drawer or a prior endorser in the event that the drawee declines to accept such bill when presented.

On the other hand, acceptance is defined by Section 132 of the negotiable instruments law as -

"The signification by the drawee of his assent to the order of the drawer. The acceptance must be in writing and signed by the drawee. It must not express that the drawee will perform his promise by any other means than the payment of money".

When a bill has been accepted, the acceptor becomes primarily liable and the contract of the drawer is substantially changed to that of endorser.

It will be observed from the foregoing that a bill of exchange, in order to be negotiable, must not only be payable to order or bearer, so that title may be transferred by the holder, but it must also be an unconditional order to pay in money.

A conditional acceptance is defined in 4 Am. & Eng. Encl. of Law, 224, as an undertaking by a drawee to pay, dependent, however, upon the performance or happening of a stipulated condition or contingency. But as shown later, a general acceptance of a conditional bill is also in effect a conditional acceptance. The terms, therefore, both of the order to pay, as indicated by the bill of exchange when drawn, and the acceptance as indicated by the language used by the acceptor, must be free from qualifications or conditions if the bill or acceptance is to retain in all respects its negotiability and to be free from equities existing between the drawer and the drawee or the acceptor. This being true, the question arises as to what form may be used to show the transaction on which the acceptance is based without destroying its negotiability.

The Federal Reserve Act provides that such bills or acceptances must grow out of transactions involving the exportation or importation of goods. It is to be assumed, therefore, that ultimately the proceeds of the sale of the goods imported or exported are to be used to extinguish the debt evidenced by the acceptance. To avoid any question of negotiability, however, neither the bill as drawn nor the acceptance made must be in terms to indicate that the payment is to be confined to such proceeds. As stated by Norton, on Bills and Notes, Third Edition, Page 138, -

> "The true test is whether the drawee is confined to the particular fund, or whether, though a particular fund is mentioned, the drawee may charge the bill up to the general account of the drawer if the designated fund turn out to be insufficient. It must appear that the bill of exchange is drawn on the general credit of the drawer. It must carry with it the personal credit of the drawer, not confined to any fund".

This being true of a bill of exchange, the question arises whether or not the contract of acceptance is wholly independent of the terms contained in the bill. The cases and authorities all agree that a general acceptance of a bill of exchange is an undertaking on the part of the drawee to pay the bill absolutely according to its tenor.

4 Am. & Eng. Encl. of Law 207.
English Bills of Exch., Act, Sec. 17.
Cox v. National Bank, 100 U. S. 712
Bailey on Bills (2nd Am. Ed.) 154.

Consequently if the bill orders payment out of a particular fund, a general acceptance thereof is an undertaking to pay out of that fund and no more, and it is, therefore, a conditional acceptance, though general in form.

Hoagland v. Erck, 11 Neb. 580.
Newhall v. Clark, 3 Cush. (Mass) 376.
Smith v. Wood, 1 N. J. Eq. 74.
Cook v. Wolfendale, 105, Mass., 401.

It is to be remembered, of course, that an acceptance may be conditional and therefore non-negotiable, even though the bill itself was unconditional, if the terms in the contract of acceptance specify that payment is to be made out of a particular fund or is dependent upon the hap-

pening of a certain contingency. As Justice Clifford stated in Cox v. National Bank, supra, "An acceptance is an engagement to pay the bill according to the tenor of the acceptance and * * * a general acceptance is an engagement to pay according to the tenor of the bill."

The difficult question, however, is to construe the words used, to apply the test given in Norton, to determine whether in fact the acceptance is conditional; or, more specifically, to determine whether the drawee is confined to a particular fund merely by a reference on the bill or in the acceptance to that fund. It is a question for the court to determine in each individual case, because, the facts being proved or admitted, the question whether an undertaking is a conditional acceptance is a question of law for the court to decide. Sproat v. Matthews 1 Term. R. 182.

It was held in Corbett v. Clark, 45 Wis., 403, that an order to "pay C. A. Corbett $183 and take the same out of our share of the grain" was an unconditional bill and a general acceptance thereof also unconditional. The court held that this was a mere direction as to the fund out of which the drawee was to reimburse himself. In Redman v. Adams, 51 Maine, 433, where the words of the bill were "charge the same against whatever amount may be due me for my share of fish caught on board schooner 'Morning Star' ", and the acceptance was general, the court held that this was a mere reference to the fund to call the attention of the drawee to his means of reimbursement.

The great majority of cases incline to the view that the presumption is in favor of an unconditional order and unless the direction on the bill or acceptance clearly and expressly directs payment to be made out of a certain fund, the court will consider it merely as a reference to the mode of reimbursement rather than an absolute restriction to the particular fund mentioned.

In a case decided in May, 1911, by the United States Circuit Court for the Southern District of New York (Hannay vs. The Guaranty Trust Company, 187 Fed. 686.) it was held that "Value received and charge the same to the account of 100/RSMI bales of cotton" written on a draft made it conditional because it limited payment to the proceeds of this particular cotton. The draft having been held to be conditional a general acceptance thereof was also held to be conditional. It is true that this decision was reversed in the United States Circuit Court of Appeals in 210 Fed. 810, but on the ground that the English instead of the American law applied to this particular transaction and without any attempt on the

part of the court to decide whether the lower court was right or wrong under the American law. Thus it is seen how difficult it is to determine how a court will rule on any specific case. The rule or test is always the same, but whether the facts are within or without the rule is merely a matter of opinion. Extreme cases are easy to decide but as the cases verge toward the center, the line of demarcation becomes hazy and difficult of determination.

It would seem, therefore, that Federal reserve banks and member banks should consider carefully the risk involved in discounting bills of exchange or acceptances which in terms indicate any particular fund or any particular property out of which payment of the draft is to be made, because of the doubt as to the construction that might be put upon such an acceptance. It would be far more prudent to require that the directions in a bill of exchange be to pay in money and to charge to the account of the drawer, without any qualification as to any particular fund. There is no doubt, however, that a reference, in general terms, on the face of a bill to the fact that it is based on the importation or exportation of goods would not make it conditional and non-negotiable.

Respectfully,

(Signed) M. C. ELLIOTT.

Counsel.

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