

## FEDERAL RESERVE BOARD

WASHINGTON

February 23, 1915.

My dear Governor:

The attached letter from Governor McDougal raises the question whether drafts "payable on arrival of car" are eligible for rediscount by Federal reserve banks.

Section 13 of the Federal Reserve Act provides that any Federal reserve bank may discount "notes, drafts, and bills of exchange arising out of actual commercial transactions", and though this language does not in express terms demand that the paper be negotiable, it must be so construed, because of the whole spirit and purpose of the Act.

The Act evidently contemplates that title to eligible paper must pass with it and that in event of non-payment a Federal reserve bank must be able to sue in its own name on such paper. To secure these rights the paper must be negotiable, otherwise the transfer would constitute a mere assignment and the holder would have to sue in the name of the payee. It must also be noted that if the paper is not negotiable a Federal reserve bank rediscounting it would hold it subject to the equities existing between the original parties to the bill. The same limitations would be imposed on the Federal reserve agent holding such paper as security for Federal reserve notes. The natural construction of the Act, therefore, is that paper must be negotiable in order to be eligible for rediscount.

The question presented in Governor McDougal's letter is whether a draft "payable on arrival of car" is negotiable. A draft to be negotiable must be an unconditional order to pay to the bearer or order a definite sum of money on demand or at a determinable future time. The drafts referred to above do not seem to comply with these conditions. Should the car fail to arrive, for any cause whatever, the draft would not be payable. The event or contingency upon which payment depends must be one which must necessarily happen in the natural course of the laws of nature. Weidler & Carpenter v. Kauffman, 14 Ohio, 455.

The Negotiable Instruments Law, Section 4, which is based on settled decisions provides that,

"An instrument is payable at a determinable future time, within the meaning of this Act, which is expressed to be payable

- (3) On or at a fixed period after the occurrence of a specific event, which is certain to happen, though the time of happening be uncertain."

In the case of Colehan v. Cooke, Willes 393, a note payable ten days after the death of the maker's father was held good on the ground that the father must die at some time and payment, therefore, was not dependent on the happening of an event which might fail to occur. But in the case under consideration, - that is, drafts "payable on arrival of car", there is no certainty whatever that the car will arrive, and such paper would probably be held to be non-negotiable on two grounds: first, that it is not an unconditional promise to pay; and second, that the time of payment is not fixed and certain because of the fact that the event by which it is determinable need not necessarily ever occur.

In all the cases on this point, there seems to be only one exception to this general rule that the note or bill must be payable at all events. That case is an English one decided some time ago - Andrews v. Franklin, 1, Strange, 21. A note payable two months after a certain ship was paid off was held negotiable even though the event was not necessarily bound to occur. The court in this case, however, admitted that paying off the ship was a contingency which would ordinarily make the note non-negotiable, but went on to explain that because this ship was a government one, the payment was a government obligation which must be performed. But even on this ground, the case has always been discredited by courts in which it has been cited.

It seems quite clear, therefore, that a note or draft "payable on arrival of car", which may or may not arrive, would very probably be held non-negotiable, both at common law and under the Negotiable Instruments Law.

Respectfully,

(Signed) M. C. ELLIOTT,

Counsel.

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

2/26/15/