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X-3723

FEDERAL RESERVE BANK  
OF SAN FRANCISCO

May 21, 1923.

In re: Promissory Notes Secured by  
Mortgages - California -  
Recent Legislation.

Walter Wyatt, Esq.,  
General Counsel  
Federal Reserve Board,  
Washington, D. C.

Dear Mr. Wyatt:

Reference is made to "Memorandum of Authorities in re Negotiability of Promissory Notes secured by Mortgages" prepared by me under date January 20, 1922. Copies of this memorandum were forwarded by this bank to the Federal Reserve Board. I understand that mimeograph copies were prepared by the Board and distributed to all of the Federal Reserve Banks.

In the memorandum referred to (pages 12 - 19) attention is called to the fact that the courts of California had adopted the extreme position of holding that when a note is secured by a contemporaneous mortgage, whether on real or personal property, both instruments having been executed as part of one transaction and having come into the possession of one with knowledge of the mortgage security, such promissory note, whether negotiable in form or not, is non-negotiable in fact. This rule has been adhered to in California in relation to promissory notes since the early case of Meyer vs. Weber, 133 Cal. 681.

Realizing the serious disadvantages arising by reason of this situation, I was requested by the officers of this bank to attempt to obtain some remedial legislation at the session of the California Legislature just adjourned. After conferring with the legislative committee of the California Bankers Association, and with the support of that association, I caused to be introduced at the recent session of our Legislature a bill amending section 3265 of the Civil Code of this State. The amendment is underscored on the copy of the bill transmitted herewith. I am glad to say that this bill was passed by both houses of the Legislature and was signed by the Governor on May 3, 1923. It becomes effective August 18, 1923.

It of course remains to be seen what effect the courts of this State will give to the added provision. Section 726, C. C. P. which provides that only one action may be brought to enforce an indebtedness secured by mortgage and that such action must be by way of foreclosure, was not changed. The holder of a promissory note secured by a mortgage cannot, in this State, disregard the mortgage security and bring action upon the note as though it were unsecured unless the mortgaged property has, without fault on the part of the mortgagee, become entirely valueless. It is possible, therefore, that the courts will hold that since the holder of the mortgage note must come into a court of equity and foreclose under the mortgage, he is bound by such terms of the mortgage as secure equities between himself and the mortgagor. In view of the clear intention of the Legislature, as expressed in the recently enacted statute, however, I do not see how this conclusion can reasonably be reached.

Not long ago, we had some correspondence with the Federal Reserve Bank of Boston relative to the refusal of that bank to purchase certain paper originating in California and secured by mortgages executed in this state on cattle. The Federal Reserve Bank of Boston stated that their reason for refusing to take the paper was that under the memorandum prepared by me and in their possession, it clearly appeared that such paper was non-negotiable and therefore ineligible. In order that the banks may be advised of this recent change in the California law, I suggest that copies of the bill be forwarded to the various Federal reserve banks with such comments as you may deem appropriate.

Yours very truly,

(Signed) Albert C. Agnew

Counsel.

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X-3723-a

AMENDED IN ASSEMBLY MARCH 27, 1923.

ASSEMBLY BILL

NO. 288

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INTRODUCED BY MR. SPENCE,

January 25, 1923.

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Referred to Committee on Judiciary.

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An act to (amend section three thousand two hundred sixty-five of the Civil Code, relating to negotiable instruments.)

The people of the State of California do enact as follows:

(Section 1. Section three thousand two hundred sixty-five of the Civil Code is hereby amended to read as follows:

3265. A negotiable promissory note within the meaning of this title is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer but the negotiability of a promissory note otherwise negotiable in form, secured by a mortgage or deed of trust upon real or personal property shall not be affected or abridged by reason of a statement therein that it is so secured, nor by reason of the fact that said instrument is so secured nor by any conditions contained in the mortgage or deed of trust securing the same. Where a note is drawn to the maker's own order it is not complete until indorsed by him.)

Passed by both houses of the Assembly and signed by the Governor May 3, 1923. Effective August 18, 1923.