FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-4975

October 18, 1927.

SUBJECT: Topic for Governors' Conference.

Dear Sir:

The Governor of the Federal Reserve Bank of Dallas has advised the Board that he has forwarded to the Governor of each other Federal reserve bank, copy of an opinion rendered by Counsel for that bank with respect to the effect upon the negotiability of bankers' acceptances of certain language contained in the standard form of endorsement placed thereon by the accepting banks to show the eligibility of the acceptances for rediscount at Federal reserve banks.

It is understood that this question will be given consideration at the forthcoming conference of Governors. The question has been referred to Counsel for the Federal Reserve Board and the Board has approved a recommendation made by him that the conference be requested to consider certain suggestions set out in a memorandum addressed to the Board, copy of which is enclosed herewith.

By direction of the Federal Reserve Board.

Walter L. Eddy,
Secretary.

TO: GOVERNORS OF ALL F.R. BANKS EXCEPT DALLAS.

October 7, 1927.

Federal Reserve Board

Negotiability of certain forms of bankers' acceptances.

Mr. Vest - Assistant Counsel.

The attached letter from Governor Talley of the Federal Reserve Bank of Dallas suggests that the language contained in the standard form of endorsement placed on bankers' acceptances by the accepting banks to show eligibility for rediscount in accordance with the Board's regulations may render such acceptances nonnegotiable. He encloses a copy of an opinion of Counsel for the Federal Reserve Bank of Dallas to the effect that the following language would render bankers' acceptances nonnegotiable:

> "This acceptance arises from the domestic storage of cotton and was secured at the time of acceptance by documents securing and conveying title to ______ bales and will remain so secured throughout the life of this acceptance."

This conclusion is based on two grounds (1) that the language used comes within the recent Texas decision of Lane Company v. Crum in which a trade acceptance was held to be nonnegotiable, and (2) that an acceptance having this language contains a promise to do an act in addition to the payment of money.

The following are the forms of certification of acceptance approved by the Board in 1921 for use on the several types of bankers' acceptances:

"Domestic Shipments: 'At time of acceptance, this bill was accompanied by shipping documents evidencing the domestic shipment of (name of commodity) from (point of shipment) to (place of destination).

(Name of Acceptor)'

"Import and Export Transactions:

'This acceptance arises out of a transaction involving (importation/exportation) of (name of commodity) from (point of shipment) to (place of destination).

(Name of Acceptor)'

"Warehouse Secured Credit:

'This bill was secured at the time of acceptance by independent warehouse, terminal, or other similar receipt conveying security title to (name of readily marketable staple) stored in (country where stored) and the acceptor will remain secured throughout the life of the bill.

(Name of Acceptor)' "

It will be noted that the last two of the certificates above quoted contain language substantially the same as certain parts of the endorsement considered by Counsel for the Dallas Federal Reserve Bank to render acceptances nonnegotiable.

In the case of Lane Company v. Crum, the Supreme Court of Texas held that the following language in a trade acceptance rendered it nonnegotiable:

> "The obligation of the acceptor hereof arises out of the purchase of goods from the drawer, maturity being in conformity with the original terms of purchase."

In order to meet this decision the Federal Reserve Board recommended a change in the standard form of trade acceptance so as to eliminate therefrom the clause quoted and to insert in lieu thereof the following: "The transaction which gives rise to this instrument is the purchase of goods by the acceptor from the drawer."

I can see no essential difference between this provision recommended to overcome the decision in Lane Company v. Crum, and the statement "This acceptance arises from the domestic storage of cotton * * *," which was considered by Counsel for the Federal Reserve Bank of Dallas to come within this Texas decision. If his conclusion is correct, the new provision of the standard form of trade acceptance would seem to be ineffective to accomplish the desired result.

In my opinion, however, the language, "This acceptance arises from the domestic storage of cotton * * *" does not come within the Lane Company decision and does not render an acceptance nonnegotiable. It will be observed that the language just quoted does not contain the words "the obligation of the acceptor" found in the language considered in the Lane Company case. The opinion in that case indicates that these words were the basis of the decision, on the theory that the obligation of the acceptor arose not from the instrument but from collateral transactions. The absence of these words in my opinion takes the language out of the Lane Company case. The Negotiable Instruments Act, which has been uniformly adopted, expressly provides that a negotiable instrument may contain a statement of the transaction which gives rise to the instrument. It would seem that the clause, "This acceptance arises from the domestic storage of cotton * * *" as well as the new provision in the standard form of trade acceptance comes clearly within this provision of the Negotiable Instruments Act. The same may be said also of the form of certificate for acceptances arising out of import and export transactions approved by the Board in 1921 and quoted above.

The second reason for the conclusion reached by Counsel for the Federal Reserve Bank of Dallas is that the provision that the acceptance "will remain so secured throughout the life of this acceptance" is a promise to do an act in addition to the payment of money. Similar language is found in the form of certificate of acceptance approved by the Board in 1921 for acceptances covering the storage of readily marketable staples.

Although the Negotiable Instruments Act provides "An instrument which contains an order or promise to do an act in addition to the payment of money is not negotiable", the better rule seems to be that an additional promise which does not impair the obligation to pay the certain amount of money, but which tends to facilitate rather than to impede its collection, does not affect negotiability. 8 Corpus Juris, page 126. The same rule is stated in substantially the same language in 1 Daniel on Negotiable Instruments, page 80. Thus, in the case of Farmer v. First National Bank, (Ark.) 115 S.W. 1141, a note containing a stipulation by the maker to have the property securing the same insured was held to be nevertheless negotiable. The Court said:

> "Here the recitals of the fact of the mortgage as a collateral to the note and of the promise to have the property insured as an additional security do not in any wise impair the obligation to pay the certain amount in money named. It does not tend to impede, but rather to facilitate, its collection. The promise to pay a certain sum of money at a certain time remains absolute. The collateral contract does not affect the principal obligation except to aid in its fulfillment. The note therefore remains a 'courier without luggage.' "

In the case of Cherry v. Sprague, (Mass.) 72 N.E. 457, the Court said "It is settled that the incorporation into an instrument which contains an unconditional promise to pay a definite sum of money of additional stipulations does not of itself necessarily deprive the instrument of the character of a promissory note * * * If the additional stipulation relates to the manner in which the unconditional promise to pay a definite sum may be enforced, and does not change the promise from one to pay that sum absolutely and at all events, or change the general nature of the whole contract, the instrument is a promissory note, notwithstanding additional stipulations relating to the manner of enforcement of the promise if it shall be broken."

There are one or two cases which at first glance appear to be contrary to the authorities above cited on this question. Thus, in the case of Strickland v. National Salt Company, (N J.) 81 Atl. 828, a provision by which the maker promised to keep the property securing the instrument FREE from encumbrances and of the same value as when it was pledged was held to be a promise to do an act in addition to the payment of money and, therefore, the instrument was considered nonnegotiable. In that case, however, the maker of the instrument had agreed to do certain other things besides keeping the property free from encumbrances, and there were other grounds which the court also considered in reaching the conclusion that the instrument was nonnegotiable. In the case of Bright v. Offield, (Wash.) 143 Pac. 159, it was held that a provision to the effect that if the maker should permit the taxes on mortgaged property to become delinquent the whole amount of the instrument should become at once due and payable, was in effect a promise to pay taxes on the mortgaged property, thus making the amount of the note uncertain because of the uncertainty as to the amount of taxes, and the note nonnegotiable. The court reached this conclusion, however, primarily on the ground that this provision was in

effect
/a conditional promise to pay an uncertain sum of money.

In the case under consideration the acceptor of the bill agrees to pay a certain sum of money in accordance with the terms of the bill. In addition he states that he will remain secured throughout the life of the bill. This provision, however, does not in any way render conditional his promise to pay or render the amount to be paid uncertain. It does not impede the collection of the instrument in any way; if anything it facilitates its collection. Applying the above authorities to the present case, therefore, it would seem that under the better rule a provision to the effect that the acceptance or the acceptor will remain secured throughout the life of the acceptance would not affect the negotiability of the instrument. In my opinion this is the conclusion which the courts of most jurisdictions would reach on this question, although there may be some doubt as to whether this view would be taken in all jurisdictions.

CONCLUSIONS.

My conclusions may be summarized briefly as follows: The forms of acceptance approved by the Board in 1921 for acceptances arising out of domestic shipments and for acceptances arising out of import and export transactions contain no provisions which would render the acceptances nonnegotiable. The form approved for use in case of acceptances secured by readily marketable staples contains no provision which under the better rule, would render the acceptances nonnegotiable, but inasmuch as it contains the clause "the acceptor will remain secured throughout the life of the bill", there may be a few jurisdictions in which such acceptances would not be considered negotiable.

I understand from Governor Talley's letter that this matter is to be on the program for the forthcoming Governors' Conference, presumably to give consideration to some plan whereby such parts of the certificates which have been approved by the Board for use in accepting bills as make the instruments nonnegotiable may be eliminated. If desired, the possible effect on negotiability of the clause "the acceptor will remain secured throughout the life of the bill" may be avoided by having the accepting bank place the agreement to remain secured throughout the life of the bill in an instrument separate and apart from the acceptance itself and submit the same to the member bank which discounts the acceptances or directly to the Federal reserve bank, only in case of rediscount of the acceptance by the Federal reserve bank. It is doubtful, however, whether this course is desirable as a practical matter, and in view of the conclusion above reached that the clause mentioned would render an instrument nonnegotiable in few jurisdictions, if indeed, in any, it may be advisable to leave the forms of certification of acceptances just as they have been since 1921.

Respectfully,

George B. Vest
Assistant Counsel.

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I believe that on principle Mr. Vest's legal conclusions are sound; but I fear that, in view of the decision in Lane Company v. Crum, some of the courts might hold that acceptances bearing the second and third certificates are non-negotiable. In my opinion, the decision in Lane Company v. Crum was wrong; but, nevertheless, it establishes the law in the State of Texas and may be followed in other jurisdictions. The same court which decided the Crum case incorrectly, and any courts which might be inclined to follow the decision in the Crum case, would be likely to hold that such acceptances are non-negotiable.

It is highly important that there should be no question in any jurisdiction as to the negotiability of the standard forms of acceptances. I believe, therefore, that, as a practical matter, it would be desirable to change the second and third certificates quoted above in such a way as to eliminate all possible doubt of the negotiability of acceptances containing such certifications. No doubt has been cast upon the negotiability of acceptances bearing the first certificate quoted above.

RECOMMENDATIONS:

I respectfully recommend, therefore, that the Governors' Conference be requested to consider the following suggestions:

1. That no change be made in the form of certificate to be used on acceptances covering domestic shipments.

2. That the form of certificate to be used on acceptances covering import and export transactions be changed to read as follows:

"The transaction which gives rise to this instrument is the (importation) of (name of commodity) from
(exportation)

(point of shipment) to (place of destination).

____
Name of Acceptor."

3. That the certificate be eliminated entirely from the faces of acceptances secured by warehouse, terminal or other similar receipts; and that the following form of certificate be printed on a separate piece of paper to accompany the acceptance:

"This certifies that a certain bill drawn by (Name of drawer) on the undersigned for $____________ dated ___________ and accepted by the undersigned, was secured at the time of acceptance by independent warehouse, terminal or other similar receipt conveying security title to (name of readily marketable staple) stored in (country where stored) and that the acceptor will remain secured throughout the life of the bill.

____
Name of Acceptor."

This may be less convenient than a certificate on the face of the acceptance but is much safer and is no more cumbersome than an acceptance with a bill of lading or warehouse receipt attached.

I also recommend that a copy of this memorandum and the attached correspondence be sent to all Federal reserve banks for their information in connection with the discussion of this topic at the Governors' Conference.

Respectfully,

Walter Wyatt,
General Counsel.

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