

S-291
Reg. W-12INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal Reserve Banks)

August 30, 1941

TELEGRAM

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Certain questions have been received regarding the status under Regulation W of commitments made prior to September 1 to extend credit after September 1. Section 9(d) of the regulation exempts "any valid contract made prior" to September 1. An earlier ruling of the Board has indicated that this exemption applies to a written commitment made prior to September 1 with respect to a modernization job that is in process on August 31. In order to clarify further the application of this provision to outstanding commitments, certain general principles applicable to such commitments are set out below.

1. The underlying principle is that the exemption in section 9(d) for "any valid contract" made before September 1 applies not only to an extension of credit actually made before that date, but also to a valid contract to make a contract. The exemption, therefore, includes a valid commitment made in good faith before September 1 to extend credit after September 1, and includes also the credit extended pursuant to such a commitment.

2. In order for the exemption to apply there must have been a valid contract. The general test is that the borrower should, in the absence of the regulation, have been able to maintain a suit for damages if the credit had not been granted pursuant to the contract. Some of the requirements for such a contract may be briefly summarized: (a) Even an exact agreement on the sale of a particular article is not necessarily an agreement to extend credit therefor. There must have been a valid contract relating to the credit. Where there is ambiguity as to whether the contract included credit arrangements, relatively little proof would be needed in the case of a contract for a unique or "custom built" item, as for example a home modernization job, to show that the contract did include credit arrangements; but in the case of a standard article the presumption

would be strongly the other way. (b) There must in any case be considerably more than general negotiations or indefinite "understandings" that the credit would be extended. There must have been an agreement to extend the credit and a reasonably exact agreement as to terms and amount. (c) While not always essential, the case is much clearer if there is written evidence of the commitment. The time as of which the extension of credit is itself dated is not important, the significant date being that of the prior commitment.

3. Substance and good faith rather than technicalities and formalities control in determining whether there is a valid pre-September contract. The most elaborate written documents do not constitute such a contract unless they represent a bona fide commitment made as a part of a regular business transaction and not as a means of evading the regulation.

(Signed) Chester Morrill

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