NOTES

Erratum

In Note, Management Trading During Public Utility Reorganization, 67 Yale L.J. 881, 882, n.4 (1948), reference was made to the facts of SEC v. Chenery Corp., 332 U.S. 194 (1947), as follows: "[The corporate management] cornered most of the preferred stock in reorganization trading, and then proposed to the SEC that this class of stock be accorded preferential treatment." In fact, the management acquired 12,407 shares of preferred stock during the reorganization period; the total number of outstanding preferred shares was 159,269. Federal Water Service Corp., SEC Holding Co. Act Release No. 5584, p. 10, Feb. 7, 1945; SEC v. Chenery Corp., 318 U.S. 80, 84 (1943). The plan proposed by the management would have allocated 90.7% of the common stock in the reorganized corporation to the former preferred shareholders, and the management’s preferred holdings (acquired for the most part during the reorganization period) would have entitled them to 10.1% of the new voting stock. Id. at pp. 9-10. It is to be noted that 10% of a corporation’s voting power is presumptive of control under the Holding Company Act. 49 Stat. 806 (1935), 15 U.S.C. ?9(b)(7), (8)(1940).

CONSIDERATION IN NEGOTIABLE INSTRUMENTS: THE COMMERCIAL CODE ARTICLE III, SECTION 501

The new Commercial Code embodies several important modifications of the consideration doctrine in the field of negotiable instruments.1 The present Negotiable Instruments Law accepts the consideration requirement as a prerequisite of promissory liability,2 rejecting the idea (advanced by Mans-


(1) No consideration is necessary for
   (a) the obligation of an acceptor to a holder if consideration has been paid for the instrument in good faith; or
   (b) any instrument or obligation thereon given in payment of or as security for any antecedent obligation of any kind; or
   (c) any instrument given as a charitable subscription.

(2) With respect to consideration or its equivalent any other obligation on an instrument is subject to the law of simple contract, and want or failure of consideration is a defense as provided in Section 309.

It should be noted that the proposed changes deal only with the defense of lack of consideration. Failure of an agreed consideration is not affected.

2. Relevant provisions of the Negotiable Instruments Law are:
Sec. 24. Every negotiable instrument is deemed prima facie to have been issued for a
field and perpetuated by Ames and Langdell) that the promises made in a
negotiable instrument are enforceable by the custom of merchants. But con-
sideration as it has been developed in the law of negotiable instruments can-
ot in all respects be equated with the doctrine in general contract law.

Historically, the liability of parties to a negotiable instrument was spelled
out by the law merchant without reference to the common law concept of
consideration; or custom of merchants was simply interpreted as constituting
the required consideration. When common law courts began to use the
action of assumpsit for recovery on negotiable instruments, they followed the
law merchant in giving effect to mercantile custom. And later, even when
liability came to be rationalized in terms of common law forms of action
rather than of mercantile custom, courts rarely used the consideration doc-
trine to undo the work of the law merchant. Rather, the shibboleth of con-
sideration was adapted to fit commercial needs already recognized by the
rules of the law merchant. But not all commercially desirable transactions
adjusted easily to the consideration framework, and certain doctrinal anom-
alsies presented themselves.

The liability of the acceptor, for example, has evoked several types of
justification, varying with the factual context. The drawee, by accepting an
instrument, gives a promise to pay. But what is the consideration support-
ing his promise? If the holder has bought the instrument after the drawee
valuable consideration; and every person whose signature appears thereon to have be-
come a party thereto for value.
Sec. 25. Value is any consideration sufficient to support a simple contract. An anteced-
ent or pre-existing debt constitutes value; and is deemed such whether the instrument is
payable on demand or at a future time.
Sec. 28. Absence or failure of consideration is matter of defense as against any person
not a holder in due course; and partial failure of consideration is a defense pro tanto,
whether the failure is an ascertained and liquidated amount or otherwise.
Sec. 29. An accommodation party is one who has signed the instrument as maker,
drawer, acceptor, or indorser, without receiving value therefor, and for the purpose of
lending his name to some other person. Such a person is liable on the instrument to a
holder for value, notwithstanding such holder at the time of taking the instrument knew
him to be only an accommodation party.

3. Pillans v. Van Mierop, 3 Burr. 1664, 97 Eng. Rep. 1035 (1765) is the famous
case in which Lord Mansfield laid down the rule that a promise in a written instrument
is enforceable by the custom of merchants irrespective of consideration. His view did
not long prevail, however, and was specifically overruled in Rann v. Hughes, 7 T. R.

Mansfield's view long continued to receive widespread support among legal scholars.
2 Ames, Cases on Bills and Notes 876 (1881); Langdell, Summary of Contracts
63 (2d ed. 1880).

1062 (1686). See further Steffen, Cases on Commercial and Investment Paper 5
(1939).

Jac. 306, 79 Eng. Rep. 262 (1613); cf. Martin v. Boure, Cro. Jac. 6 (1603); and see Steff-
fen, op. cit. supra note 4, at 4–5.
accepts, he has clearly relied on the acceptor’s promise, and his detrimental reliance in discounting the instrument serves as consideration. But courts have not limited recovery against acceptors to holders who discounted after acceptance. They have responded to the commercial need for holding the acceptor to his promise by permitting the holder to recover even where he has bought the instrument before acceptance and cannot therefore set up his own reliance in fact as consideration. If he is an indorsee, and has acquired the instrument in a commercial transaction, he is clearly a holder for value, and it is not material that the acceptor received no consideration or that there was no detrimental reliance by the holder. But where the discounter before acceptance is a payee rather than an indorsee, one might expect more difficulty, since it is not easy to classify a payee as a holder for value. The courts have, however, been equal to the occasion. In one instance, the court permitted the bill to be introduced as evidence of money had and received by the acceptor from the drawer for the use of the payee. But most courts have simply ignored possible difficulties and come to the conclusion that the payee is a holder for value. Once he has been awarded that tag, he need not worry about defenses which the acceptor has against the drawer.

Whatever the rationale used to hold the acceptor, the motivation seems to be simply this: the drawee has the option of deciding whether he wants to accept and thereby subject himself to liability. Once he elects to be liable, he won’t be allowed to thwart a commercially desirable transaction by setting up the defense of no consideration, either between himself and the holder or between himself and the drawer. The same stress on the commercial importance of the acceptance transaction is apparent in the Commercial Code provision which clarifies existing law by eliminating the consideration requirement for the acceptance of all bills acquired by the holder in a commercial transaction.

A second complex of situations raising doctrinal difficulties involves the accommodation party. By signing the instrument, he undertakes to pay its amount; what is the consideration for his undertaking? Again, detrimental


8. Wells v. Brigham, 60 Cush. 6 (Mass. 1850).


10. Although not designated as such, the theory seems to be one of estoppel. Flournoy v. First Nat. Bank of Jeffersonville, 79 Ga. 810, 2 S.E. 547 (1887); Jarvis v. Wilson, 46 Conn. 90, 33 Am. Rep. 18 (1878) (non-negotiable instrument).

On the commercial utility of the acceptance transaction and the desirability of relaxing doctrinal requirements therefor, see Steffen, op. cit. supra note 4, at 47–8.
reliance provides the answer when the holder acquires the instrument subsequent to the accommodation party's signature, whether the accommodator signs as acceptor or in any other capacity. But when the holder has discounted before the accommodation party signs, liability in terms of reliance is more difficult to spell out. If acceptance of the instrument is refused, the holder may proceed against the drawer immediately, but if the instrument is accepted, the holder cannot proceed against the primary obligor until after maturity. This forbearance on the part of the holder is what the accommodation party bargained for, and it is consideration for his promise to pay. The holder also exercises this forbearance when a demand instrument is accepted, even if for only a brief period. But courts have not stressed the element of forbearance when dealing with demand instruments. Instead, a "prior request" fiction has proven useful: for example, the accommodation acceptor is said to have requested the holder to lend money to the drawer on the understanding that the instrument would be accepted; the acceptor is then bound by his prior request.

By far the greatest number of cases involving the accommodation party arise when he signs an instrument in order to secure someone's pre-existing debt, and the creditor gives no new promise and performs no new act in return. It can be said that the usual obligation of an original debtor—the primary obligor—to reimburse the accommodation party constitutes sufficient consideration to permit the creditor to hold the accommodator. But courts have hesitated to accept this argument. Their reluctance may be partially explained by the fact that in most cases the debtor's spouse is the accommodation party.

When the accommodator makes his note directly to the creditor as payee to secure a third party's debt, his defense of lack of consideration often allows the accommodation maker to escape liability to the creditor-payee. But the artificiality of this result is apparent. All the creditor has to do to escape this trap is to have the accommodator make his note to the debtor as payee. Then the debtor indorses it over to the creditor. According to most authority, the

11. NEGOTIABLE INSTRUMENTS LAW §§ 61, 84, 192.
13. This theory was first suggested by way of dictum in the Bank of Lake Erie case, supra note 12.
14. Widger v. Baxter, 190 Mass. 130, 76 N.E. 509 (1905). Strong v. Sheffield, 144 N.Y. 392, 39 N.E. 330 (1895), is often cited as a case where lack of consideration was at issue. It is better explained, however, as lack of agreement, since the wife asked, not for forbearance, but for a promise to forbear, which the plaintiff-creditor did not give.
15. Love and affection as between husband and wife is not consideration. Schnell v. Nell, 17 Ind. 29, 79 Am. Dec. 453 (1861). The impact of this doctrine may explain the reluctance of courts in the husband-wife situation to spell out a promise to reimburse.
creditor now wears the mantle of a holder for value, sublimely impervious to the defense of lack of consideration.  

Even if the accommodator makes his note directly to the creditor as payee, he may be liable, if the court is partial to a little verbal ingenuity. Instead of viewing the note as an executory promise to pay—requiring consideration—the court may deem delivery of the note to the creditor to effect a pledge transaction, as though the note were a diamond wristwatch. The transaction is now “executed” rather than “executory”; the creditor-payee recovers against the accommodation maker without worrying about consideration.  

But even this ingenious theory does not avail to hold the accommodation indorser who signs the instrument after it has been delivered to the creditor. And that sort of indorser is the type who escapes liability most often. The almost universal rule is that no consideration will be found to bind the after-delivery indorser, who signs for an antecedent debt.  

It appears, then, that the Code provision liberating all antecedent debt promises from the consideration requirement universalizes the rule of only the most far-reaching cases under present law.  

The existing rules on gifts made by negotiable instrument may be shortly stated. A donor's own promissory note may not be enforced against him by the donee; a gift of another person's note may be made, but the donor is not then liable in case of dishonor. Furthermore, the delivery of a check does not constitute an executed gift; even if the bank pays, the supervening death or insolvency of the drawer is said to revoke the gratuitous assignment.  

17. Grocers' Bank v. Penfield, 69 N.Y. 502, 25 Am. Rep. 231 (1877) is a well-known case which anticipated N.I.L. § 25 in reaching this result. The cases under the N.I.L. are unanimous in considering the creditor a holder for value when he takes the instrument by negotiation from his debtor.  


One further theory serves to validate the accommodation party's promise in the specialized situation of a note made to a bank. Where the note is given with the understanding that it will not be called, and is used to bolster the bank's assets and thus to deceive a bank examiner as to their status, the accommodation party is usually held on an estoppel theory. Smouse v. Waterloo Savings Bank, 198 Ia. 306, 199 N.W. 350 (1924). Liability may be imposed even where the accommodation party did not know the use to which the note was put. Mount Vernon Trust Co. v. Bergoff, 272 N.Y. 192, 5 N.E.2d 196 (1936). See further Britton, Bills and Notes 385-8 (1943); Steffen, op. cit. supra note 4, at 654.  


20. Section 517, the section on accommodation parties, reaches this result in conjunction with sections 304(b) and 501(1)(b).  


22. Notice to the bank is determinative of revocation, Glennan v. Rochester Trust &
Liability on a charitable subscription is governed in general by the doctrine of action in reliance.23

The Code leaves existing law on gift transactions undisturbed except to validate the obligation of a charitable subscription by virtue of the promise in the instrument itself, without necessitating reference to a theory of reliance.

Curtailment of the consideration doctrine as contemplated by the Code is thus expressly limited short of the extremists' position that any promise embodied in a written instrument should be enforceable, whether gratuitous or not.24 The framers of the Code have preferred to retain the consideration requirement, excepting only the three cases explicitly enumerated. In refusing to go all the way, the framers have followed the classical notion of Mansfield that it is the commercial nature of the transaction that should free negotiable instruments from compliance with the consideration requirement.

The erratic manner in which courts have applied the consideration doctrine to the acceptor and the accommodation party has frequently enabled them to escape liability. Henceforth, their liability need no longer be predicated upon a conceptualistic "finding" of consideration. The new Code will contribute a long-needed element of certainty to these commercially important transactions.

But the exception of charitable subscriptions from the consideration requirement cannot be placed upon the same grounds of commercial utility. Only by accepting, pro tanto, the otherwise rejected arguments for the enforcement of all written promises,25 can the exemption of charitable subscriptions be rationalized. Philosophic inconsistency aside, it may also be said that the problems involved in gratuitous transfers are beyond the scope of a Code whose purpose it is to deal with the world of commercial transactions.26

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24. The literature has been voluminous. For a representative statement, see Wright, Ought the Doctrine of Consideration to be Abolished from the Common Law?, 49 Harv. L. Rev. 1225 (1936).
25. Restatement, Contracts § 90.
26. The concern of the learned framers with the enforceability of charitable subscriptions would appear to be somewhat academic, in view of the fact that these promises are almost invariably enforced. By ringing changes on "promissory estoppel," courts have subserved what appears to be a well-defined public policy favoring the validity of
NEGOTIABILITY OF CONDITIONAL SALES CONTRACTS: 
THE CONSUMER AND ARTICLE III OF THE 
COMMERCIAL CODE

Conditional sellers have long sought an alchemistic formula for negotiability in consumer conditional sales contracts. Such contracts are almost invariably assigned: if they can be made negotiable, the risk of loss resulting from delivery of defective goods or other breach of contract by the seller will fall upon the consumer and not upon the finance company or bank. Thus the conditional sales paper is made more appealing to financiers. In an effort to achieve negotiability, the finance companies have, first, inserted clauses in the contract providing that the buyer waives any defenses he may have as against any assignee of the contract; second, executed, contemporaneously with the contract, negotiable notes evidencing the purchase price; and third, drafted the contract itself as a promissory note.

The courts have granted some protection to the consumer-buyer by holding that the conditional sales contract itself is non-negotiable, and cannot be so made by contractual stipulation. Thus waiver or cut-off clauses are generally termed void as against public policy, although some courts give effect to waivers of breach of warranty or failure of consideration. Further protection has been granted in other instances by circumventing the entire question.

3. JONES, CHATTEL MORTGAGES AND CONDITIONAL SALES §§ 940–2 (Bowers Ed. 1933) and cases cited therein.
6. Equipment Acceptance Corp. v. Arwood Can Mfg. Co., 117 F. 2d 442 (6th Cir. 1941); Malas v. Lounsbury, 193 Wis. 531, 214 N.W. 332 (1927). Other cases have been more specific: Motor Contract Co. v. Van Der Volgen, 162 Wash. 449, 298 Pac. 705 (1931) (cannot by contract deny oneself a right the law allows); San Francisco Securities Corp. v. Phoenix Motor Corp., 25 Ariz. 531, 220 Pac. 229 (1923) (cannot oust the jurisdiction of the court); Progressive Finance & Realty Co. v. Stempel, 231 Mo. App. 721, 95 S.W.2d 834 (1936) (cannot waive a right before it accrues).
7. U.S. ex rel. Adm’r of F.H.A. v. Troy-Parisian Inc., 115 F.2d 224 (9th Cir.
of negotiability, allowing defenses by declaring the seller-finance company relationship too intimate for the latter to be a holder in due course.\(^8\) In the usual case, however, negotiability may be attained, since notes evidencing the purchase price are generally held to be negotiable.\(^9\) And one court has gone so far as to permit the drafting of the entire conditional sales contract itself as a valid promissory note.\(^10\)

Article III of the proposed Commercial Code in general follows existing case law. The imparting of negotiability by waiver or contract to otherwise non-negotiable instruments is clearly prohibited,\(^11\) and notes evidencing the purchase price are made clearly negotiable.\(^12\)


Occasionally, however, the courts have found that specific types of clauses in these notes will destroy negotiability: Murrell v. Exchange Bank, 168 Ark. 645, 271 S.W. 21 (1925) (acceleration of maturity); Polk County State Bank v. Walters, 145 Minn. 149, 176 N.W. 496 (1920) (repossession by seller on default of payment); Sine v. Waychoff, 123 Pa. Super. 334, 187 Atl. 234 (1936) (confession of judgment before maturity).

10. Abingdon National Bank and Trust Co. v. Shiplett Moloney Co. 316 Ill. App. 79, 43 N.E.2d 857 (1942). Although the instrument was held to be a negotiable promissory note, in reality it was a conditional sale contract drawn with considerable ingenuity in the form of a note and as closely as possible in the terms authorized by the Negotiable Instruments Law.

11. \textsc{American Law Institute and Nat'l Conf. of Com'rs on Uniform State Laws, the Code of Commercial Law} Art. III (Proposed Final Draft No. 2, 1948) § 102(2).

12. Unless otherwise prohibited by statute, Article III specifically permits the fol-
Whether or not the Code thus provides sufficient protection for the buyer must depend principally on the factual setting of the conditional sale. At first blush, the protection would seem inadequate. The typical conditional selling arrangement, the installment sale, is a tri-partite transaction in which the buyer purchases from the seller, who then assigns all relevant paper to a finance company or commercial bank. The relationship between vendors and financiers is characterized by their mutual interdependence, the conditional vendor relying upon the discounting facilities of the financing agency to enable him to sell, the finance company deriving its profits from this discounting process. The buyer, handicapped by his inferior economic status and often ignorant of his legal rights, is in the subordinate bargaining position.

The following clauses in negotiable instruments: good faith insecurity acceleration, §§ 108(1)(c), 119(1); sale of security on default, § 111(1)(b); reference to the conditional sale contract which gave rise to the note, §§ 104(1)(b), (c); title retention, § 104(1)(d); installments, § 105(1)(a); collection costs and attorney's fees, § 105(c); acceleration on default of payment of an installment, § 108(1)(c).

It has been estimated that installment sales represent 11% of all retail sales. Mindel, Retail Installment Selling 4 (Research Report No. 6, Maryland Legislative Council, Research Div. 1940). Installment sales credit from 1929 to September 1947 varied from a low of $1,526 millions in 1932 to a high of $5,298 millions at the end of September 1946. 33 Fed. Res. Bull. 1418 (1947). For an extensive treatment of the volume of installment sales, see generally Holthausen, Volume of Consumer Installment Credit 1929-38 (1940).

“The finance company and the merchant-seller are as a fact engaged in one business... useless one without the other.” Buffalo Industrial Bank v. De Marzio, 162 N.Y. Misc. (Buffalo City Ct.) 742, 744, 296 N.Y.S. 783, 785-6 (1937). The relationships between vendor and financing agency rest upon more or less informal agreements and understandings, with close integration of their respective operations. Plummer and Young, Sales Finance Companies and Their Credit Practices 115 (1940); Adelson, supra note 1 at 222, Chapman, Commercial Banks and Consumer Installment Credit 19, 230 (1940); Seligman, Economics of Installment Selling 65-87 (1927).

In addition to discounting sales paper, the financing agencies generally grant wholesale credit to conditional sellers for floor planning their stock in trade. Chapman, supra at 82, 232. And generally the financing agency supplies the contract forms to vendors. Adelson, supra note 1 at 219.

See generally Dauer, Comparative Operating Experience of Consumer Installment Financing Agencies and Commercial Banks (1944); Plummer, Installment Selling in 8 Encyc. Soc. Sci. 74, 78 (1932); Plummer and Young, supra at 107-8, 115; Ayres, Installment Selling and Finance Companies, 196 Annals 121, 122 (1938).

Prior to the institution of wartime credit controls, 90% of families with installment sale indebtedness had incomes of less than $3,000 per year, while 31.9% were families with incomes of from $1750 to $2000 per year. Mindel, op. cit. supra note 13, at v.; see generally Plummer and Young, op. cit. supra note 14, ch. 3; Bernstein, The Pattern of Consumer Debt (1940). Installment buying is still being concentrated in the low and middle income groups. Board of Governors of the Federal Reserve Board, Survey of Consumer Finances, 7 (1947).

See Note, 49 Harv. L. Rev. 128, 130 (1935).

17. Id. at 130. Nugent and Henderson, Instalment Selling and the Consumer, 173 Annals, 93, 101 (1934); Note, 16 Wash. L. Rev. 158, 159 (1941).
The vendor and financing agency may subject the vendee to high interest rates and the threat of repossession should he default in his payments. To add to this already dominant position of the financing agency the extensive liability owed to a holder in due course of a negotiable instrument would appear at least superficially inequitable when the vendee has been subjected to a seller's improper business practices. That the vendee may have an action over against the vendor is of dubious value to him in view of the expense and uncertainty of litigation and the possibility of loss through the seller's insolvency.

The operation of the business of instalment selling, however, suggests that the buyer's burdens may in some cases be more apparent than real. Where the transaction has been cast in the form of a contract plus a negotiable note, the finance company has a holder in due course position only with respect to the money claim evidenced by the note since the note does not impart its negotiability to the accompanying contract, the right to repossess will be subject to buyer defenses. Where a contract containing a waiver clause is used in those jurisdictions which do not declare the clause void, the finance company may as a matter of legal doctrine repossess without regard to defenses based on the defective quality of the goods sold. It is apparent, however, that the continued profitable operation of the finance company depends on its dealers staying in business. The damage that will be done to a dealer's reputation in his community if the financer refuses to allow adjustments to be made for defective merchandise is obvious and is probably an effective sanction against the finance company's use of its full legal rights. Furthermore, a money claim against the consumer is of no great value for he may be judgment proof; repossession of defective goods does not give the finance company a full recovery in any case, since the defect will presumably decrease the amount that can be realized on the resale. In fact, the larger finance companies make no attempt to collect or repossess over apparently valid claims of defectiveness but recognize and favor good faith adjustments between buyers and dealers. The finance companies rather seek to protect themselves

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18. The cost of instalment credit usually varies from 10% up to 40%. Plummer, Instalment Selling, 8 Ency. Soc. Scd. 79 (1932); Minder, op. cit. supra note 13, at vi, 23; Dauer, Comparative Operating Experience of Consumer Instalment Financing Agencies and Commercial Banks v, 8, 10 (1944).

19. Uniform Conditional Sales Act § 16. Note, 16 Wash. L. Rev. 159 (1941); Adelson, supra note 1, at 223. In the absence of requirements for an accounting by statute or case law, the seller is able not only to repossess the article but also to retain any payments already made in the event that the buyer defaults in his payments.

20. Improper practices are "rare in comparison with the total number of transactions handled, but they are common enough to be a serious source of loss, particularly since the dealer who engages in them usually does so on a large scale." Plummer and Young, op. cit. supra note 14, at 114.


22. See Vold, Sales, 287-8 (1931); Bogert, Commentaries on Conditional Sales, 2 A Uniform Laws Annotated 138 (1924).
by terminating financing arrangement where a dealer habitually sells shoddy merchandise. Or occasionally, finance companies safeguard themselves either by collecting from the dealer under an assignment permitting recourse against the assignor on breach of the contract, or, if the assignment be technically "without recourse," by withholding payment to the dealer under a "reserve" clause. Hence it would seem that reputable financing agencies cannot materially benefit from negotiability, and attempts to secure such negotiability are merely part of the mores of instalment selling.23

Where, however, the financing agency is marginal or predatory, it may be unable or unwilling to absorb losses occasioned by seller malpractices or to make adjustments between vendors and purchasers, particularly where the vendor has become insolvent. In this restricted situation, it seems that the buyer should be provided with statutory safeguards.

Article III might have been drafted so as to outlaw negotiability and thus to achieve some consumer protection. The wisdom of incorporating such measures within Article III is, however, open to question. A provision precluding negotiability in conditional sales notes would have to be clearly restricted to consumer instalment sales, for negotiability may be desirable in industrial instalment sales where the buyer is sufficiently large and financially potent so as to require no special protection.24 Such a restriction would require unwieldy delimiting phraseology, out of phase with the remainder of the Commercial Paper Article which is aimed at broadly defining negotiability and its legal consequences within the commercial field as a whole. Moreover, the restrictive language might result in attempts at evasion in order to apply non-negotiability outside of the narrow context of the consumer instalment sale.

Even if Article III were to be drafted to ban negotiability it would achieve only partial protection for the consumer, for it would fail to rectify the conditions and practices which give rise to the need for defenses. It would seem more feasible and effective to safeguard the buyer through the type of specialized retail instalment sales statute already enacted in several jurisdictions which regulate the entire instalment sale mechanism.25 Thus conditional

23. These conclusions are based upon interviews with sales finance company officials in the New York and Connecticut areas. The reluctance of finance companies to allow investigation of their books precludes empiric documentation, however. The ultimate conclusion of the relative unimportance of negotiability to the reputable finance company is partially supported by the fact that General Motors Acceptance Corporation's conditional sale contract contains neither a note, nor a cut-off clause. Form GMAC 106-Conn. 10-47.

24. For a thorough treatment of the considerations and operative factors in commercial and industrial instalment sales, see Jacoby & Saulnier, Financing Equipment for Commercial and Industrial Enterprise (1944).

25. These statutes are generally of two types. There is the "disclosure statute" which compels the seller to make full disclosure of provision of instalment agreements, and outlaws the use of objectionable contract provisions. E.g., N.Y. Pers. Prop. Law § 64a; 9 Mass. Laws Ann. c. 255, §§ 11-13H (Supp. 1947). The other view seeks to
vendors and finance companies may be subjected to administrative surveillance through licensing; the form, content and status of instruments of sale may be specified; undesirable selling practices and conditions may be outlawed; and fair remedies for vendors, vendees, and financers may be prescribed. Such specific legislation, functionally designed for comprehensive consumer protection and equalization of the disparate position of the parties in the installment sale, seems preferable to an inept and relatively ineffective utilization of Article III for this purpose.

**BANK CREDIT AS VALUE: THE COMMERCIAL CODE**

**ARTICLE III**

A depositor, having sold certain goods, indorses a check for $1,000 drawn in his favor by the buyer and transfers it to his bank. He receives in exchange a credit of $1,000 on his account, and his bank forwards the check.


For a particularly good discussion of retail installment sales legislation, see Donaldson, *Retail Installment Sales Legislation*, 19 Rocky Mt. L. Rev. 135 (1947). See also Chapman, *Commercial Banks and Consumer Installment Credit*, 60 (1940); Plummer & Young, *Sales Finance Companies and Their Credit Practices*, c. 10 (1940).

*This note is restricted to cases involving negotiable instruments which have been dishonored or are likely to be dishonored. It should be noted, however, that the question of bank credit as value, as part of the broader question of "holder in due course" status, is frequently raised in cases arising out of bank failure or garnishment proceedings where the basic issue is ownership of the proceeds from an instrument rather than recovery on a repudiated item. Cf. Blacher v. Nat. Bank of Baltimore, 151 Md. 514, 135 Atl. 383 (1926) (suit for recovery of proceeds where depositary bank failed), Nat. Bank of Commerce v. Morgan, 207 Ala. 65, 92 So. 10 (1921) (suit to attach proceeds).

As long as courts continue to inject the "holder in due course" issue into "ownership" cases, it must be recognized that selection of a rule governing bank credit as value will affect the outcome in those cases as well. But rules governing "ownership" could easily be established independently of credit-as-value rules. See Steffen, *The Check Collection Muddle*, 10 Tulane L. Rev. 537, 560 (1936); Turner, *Deposits of Demand Paper as "Purchases"*, 37 Yale L. J., 874, 894-5 (1928); Townsend, *Bank Deposits of Commercial Paper*, 7 N.Y.U.L.Q. Rev. 293, 332-3 (1929). Parallel discussion of these two facts, therefore, does not seem essential.
for collection. Meanwhile, however, the buyer has discovered that the goods
were not what he had believed them to be, and, claiming fraud, he stops pay-
ment on the check. In suit against the buyer-drawer for payment, the bank
will argue that it is a "holder in due course" of the dishonored instrument;
for as such a holder it is immune from the buyer's defense of fraud, valid as
that defense might be if the depositor had retained the check and was him-
self suing for recovery.1 But the bank's position as a holder in due course
depends on whether the credit which it gave the depositor constitutes "value."

This question, which involves credit extended for checks and other types
of negotiable instruments, has long been a source of controversy;2 especially
since the Negotiable Instruments Law fails to specify clearly what rule
should be applied. Section 25 of the N.I.L. defines value as "any consider-
ation sufficient to support a simple contract." Since executory promises are
within this category, § 25 presumably means that the mere extension of credit
is value—i.e. that a "promise to pay" is value per se.3 But N.I.L. § 54 pro-
vides that if notice of defects is received before a holder has "paid the full
amount agreed . . . he will be deemed a holder in due course only to the
amount theretofore paid by him"—language which indicates that the credit
must actually be used by the depositor before it constitutes value.4 The courts
have adopted the latter interpretation.5 This choice requires, however, that
they also select an accounting rule to be applied in determining whether the
particular credit given for an instrument has been withdrawn. There are
several possibilities.

There is no disagreement as to accounting rules where the depositor's ac-
count has fallen to zero between the date of transfer of the instrument and
notice to the bank of its defects, for clearly the credit has been withdrawn

1. Negotiable Instruments Law §§ 52, 57.
2. See generally, Brannan, Negotiable Instruments Law 375-85 (Beutel 6th ed.
1938); Frye, Crediting an Account as "Value", 2 Wis. L. Rev. 408 (1924); Comment,
33 Yale L. J. 629, 633-6 (1924); Notes, 7 Minn. L. Rev. 583 (1923), 72 U. of Pa. L.
Rev. 61 (1923), 77 id. 690 (1929), 80 id. 1159 (1932), 26 Ill. L. Rev. 579 (1932), and
17 Va. L. Rev. 720 (1931). Cases are collected in Brannan, supra, and Notes, 6 A.L.R.
252 (1920), 24 A.L.R. 901 (1923), 60 A.L.R. 247 (1929), 80 A.L.R. 1064 (1932), and
10 C.J.S. 803 (1938).
3. This interpretation has been insisted upon by some writers. See Brannan,
Negotiable Instruments Law 376, 588 (Beutel 6th ed. 1938), and Beutel, The Proposed
4. Steffen argues that "a credit is at most a promise to pay for an instrument, not a
payment." Steffen, supra note * at 561 n.112. To say that unused credit is value paid
". . . is to read § 54 of the N.I.L. entirely out of the act." Id. at 560. But see Beutel in
Brannan, op. cit. supra note 3, at 376: " . . . this section does not apply to credits be-
cause the credit itself is the full amount to be given."
5. E.g., Bath Nat. Bank v. Sonnenstrahl, 249 N.Y. 391, 164 N.E. 327 (1928), and
cases collected in Note, 6 A.L.R. 252, 255-6 (1920). But see McAuley v. Morris Plan
Bank, 155 Va. 777, 787, 156 S.E. 418, 421 (1931); Farmers & Merchants Bank v. Nissen,
46 S.D. 121, 123, 190 N.W. 1014, 1015 (1922) (bank paid for note by reduction of its
account with transferor bank).
and the bank has given "value." A dispute has arisen, however, in cases involving active accounts, with numerous withdrawals largely offset by additional deposits between the two dates. The depositor, for example, has an original balance of $1,000 and receives credit for $1,000 on a time note endorsed over to his bank. Prior to dishonor of the note he deposits an additional $1,000 but withdraws $2,600, leaving a balance of $400. In this situation, most courts have applied the rule of "first money in, first money out." Withdrawals are charged against credits in accordance with the time sequence in which the credits were entered. Thus the bank is here a holder for value to the full amount of the note—the same result reached under the rejected rule that credit is value per se. But under the minority rule of "lowest intermediate balance," credit for a dishonored instrument is disregarded in charging withdrawals except to the extent necessary to prevent overdrafts—in the example given, $600 is the limit to which the bank can claim to be a holder for value.

That neither of these rules has proved entirely satisfactory to the experts in the field is indicated by two recent proposals. The drafters of the Commercial Code, adopting both § 25 and § 54 in the parts on commercial paper, suggest in the sections on bank-collections a compromise rule to govern bank credit given for checks:

"* * * first credits given shall be deemed the first to be withdrawn, but credit not available for withdrawal as of right shall be deemed to be used only if necessary to prevent an account from being overdrawn when balances are posted."

In effect, this is the "intermediate balance" rule so long as there is only one credit outstanding on an uncollected item; if, however, there are two or more

6. E.g., Bank of Gulfport v. Smith, 132 Miss. 63, 95 So. 785 (1923), and cases collected in Note, 6 A.L.R. 252, 259-60 (1920).

7. E.g., Modern Industrial Bank v. Hegeman, 54 N.Y.S. 2d 251 (1945); aff'd, 269 App. Div. 775, 55 N.Y.S. 2d 576 (1945), and cases collected in Note, 6 A.L.R. 252, 262-3 (1920). Accord: First Nat. Bank of Appleton v. Court, 183 Wis. 203, 197 N.W. 793 (1924), which in distinguishing the earlier case of Curry v. Wisconsin Nat. Bank, 149 Wis. 470, 112 N.W. 999 (1907), stated that there the "first in, first out" rule would have worked injustice.

The Appleton case illustrates the comparative effects of the two rules. Suit was on a note for $1,000. Balance prior to deposit of the note was over $20,000, and the lowest subsequent balance was that on date of dishonor—$899.15. But withdrawals on one day during the period exceeded $90,000, the account being maintained by additional deposits. Under the majority rule here applied, the bank was ruled a holder for full value. Under the alternative rule it would have been holder for value only to the extent of $100.85.


10. A.L.I., COMMERCIAL CODE Art. III, § 714(2). This provision appears to avoid
such credits, and one must be used to prevent overdraft, the above rule may make the bank a holder for value where the "intermediate balance" rule does not.\footnote{11} The Code section governing credit given for instruments other than checks, on the other hand, adopts the principle hitherto rejected by the courts: that mere extension of credit is value per se even when not subsequently withdrawn.\footnote{12} This position is also maintained in the proposed Uniform Revised Sales Act.\footnote{13}

The soundness of applying one rule to checks and another to such instruments as time notes may be seriously questioned, whatever the merits of the respective rules. There is little basis for believing that instances of dishonor will involve one type of instrument more frequently than another. To be

the logical difficulties of both the "first in, first out" rule (which charges against credit for an uncollected item even though adequate deposits of cash are available) and the "intermediate balance" rule (which is logical only if subsequent deposits are cash). For more extensive discussion of this problem, see Note, 72 U. OF PA. L. REV. 61, 64-5 (1923).

11. A comparison of this proposal with the two current rules may be made by using the following example:

<table>
<thead>
<tr>
<th>Days</th>
<th>Amount</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov. 1</td>
<td>Initial balance 1,000.</td>
<td>1,000.</td>
</tr>
<tr>
<td>Nov. 2</td>
<td>Item later dishonored 1,000.</td>
<td>2,000.</td>
</tr>
<tr>
<td>Nov. 3</td>
<td>cash deposit 1,000.</td>
<td>3,000.</td>
</tr>
<tr>
<td>Nov. 4</td>
<td>withdrawal 2,000.</td>
<td>1,000.</td>
</tr>
<tr>
<td>Nov. 5</td>
<td>time note 1,000.</td>
<td>2,000.</td>
</tr>
<tr>
<td>Nov. 6</td>
<td>withdrawal 1,000.</td>
<td>1,000.</td>
</tr>
<tr>
<td>Nov. 7</td>
<td>cash deposit 1,000.</td>
<td>2,000.</td>
</tr>
</tbody>
</table>

If dishonor of the "spurious" item takes place after November 4th, then the "first in, first out" rule makes the bank a holder for value while the new rule does not. If dishonor is after November 6th or 7th, then both the "first in, first out" and the new rule would grant freedom from the maker's defenses, while the "intermediate balance" rule would not.

12. A.L.I., COMMERCIAL CODE Art. III, §720:

"A depositary bank extending credit available for withdrawal as of right against a depositor's non-cash items has a lien upon the items and any accompanying documents whether the credit is used or not and irrespective of any right of charge-back in the event of difficulty in collection."

13. Value is defined to include "... the extension of immediately available checking credit by a financing agency against a draft accompanied by document of title, whether or not drawn upon and whether or not a charge back is provided for in event of difficulties." A.L.I., COMMERCIAL CODE Art. II (Uniform Revised Sales Act, 1948), §56(3)(b).

It is not entirely clear how this provision and the provision in the Commercial Code governing exchange of credit for non-cash items are to be reconciled with the Code provision on credit exchanged for checks. See notes 10 and 12 supra. It has been suggested that deposit of checks does not result in "immediately available" credit to the depositor, and that therefore there is no conflict. A.L.I., COMMERCIAL CODE, Notes & Comments to Part VII, Art. III (August 1948) 19. There is some doubt, however, that this distinction is realistic in all cases. See Moore, Corstvet and Sussman, Drawing Against Uncollected Checks, 45 YALE L. J. 1, 260 (1935).
sure, rapid clearance of checks, in contrast to delayed collection of time notes, severely restricts the drawer's opportunity of preventing payment by a stop-order—e.g., after discovering that goods purchased are defective—but the vastly greater volume of checks offsets this fact. Nor is there any justification for believing that subsequent behavior of the depositor's account will depend on the type of instrument involved. An uneasy depositor is just as likely to attempt immediate withdrawal of his credit whether the instrument is a check or a note. It would seem therefore, that a uniform principle applicable to all negotiable instruments could be selected, the choice depending on evaluation of the several rules in terms of simplicity, protection to banks, and possible inequities to other parties.

There is no doubt that value per se, by dispensing with accounting problems, excels the other rules in simplicity. It is equally clear that this rule alone grants protection to the banks in all cases, a factor which under most circumstances would materially foster negotiability. However, where an attractive alternative to suit against the maker or drawer is available, the importance of selecting a rule on the basis of protection to banks is doubtful.

Precisely such an alternative is the widespread custom of "charging back" a defective instrument against the depositor (i.e. debiting his account by the amount of the instrument), a practice apparently sanctioned whether the


15. It may or may not be significant that the leading cases dealing with the "first in, first out" rule, e.g., First Nat. Bank of Appleton v. Court, 183 Wis. 203, 197 N.W. 793 (1924), are cases involving notes. A similar question may be raised concerning the fact that apparently only seven cases reached appellate courts during the years 1936-1946, of which three involved checks and four involved notes. 7 Fifth Decennial Digest 929 (1948). The paucity of cases may reduce the importance of the credit-as-value issue.

16. The practice is employed almost universally in the handling of checks, by far the most important type of negotiable instrument. For brief discussion, see Turner, supra note * at 889ff.; Townsend, supra note * at 325ff.

Empirical evidence of the actual extent of the charge-back in the handling of time notes is not readily available. Conversations with banking officials in New York and New Haven disclose that it is virtually standard practice in those cities, but not so openly formalized as to appear in banking manuals. Procedures include "suggestion" to the depositor that he take care of the matter (which, they say, the depositor does), segregation of funds upon notice of difficulties, and the rather startling practice of entering an automatic debit on date of maturity (erased if proceeds are received). On the other hand, it has been suggested that banks in the Middle West and South are reluctant to debit the customer's accounts (letter to the Yale Law Journal from Mr. Allen Axelrod, Assistant Professor at the University of Nebraska Law School). In at least one case the instrument was returned in exchange for the depositor's check, a practice more formal but no less effective. Nat. Bank of Commerce v. Bossemeyer, 101 Neb. 96, 163 N.W. 503 (1917).
bank is a holder in due course or not. Given the charge-back, the position of a bank is this: if the depositor's account is inadequate to cover the amount of the dishonored check or note, the bank is a holder for value at least to the extent of the deficiency under any of the alternative rules on credit, and free from such defenses as fraud practiced upon the maker; if the account is adequate, the protection accorded a holder for value is unnecessary. Hence the banks do not need the value per se rule. But neither do they need pro-

On charge-back of defective demand drafts, see cases collected in Townsend, supra note at 335 n.153.


18. E.g., Union Nat. Bank of Columbus v. Winsor, 101 Minn. 470, 473, 112 N.W. 999, 1000 (1907): "... the bank was not a holder for value. Upon receiving notice of the fraud, it had the right to charge the note to [the payee's] account and leave them to contest the validity of the note with the makers." See generally, Townsend, supra note 1 at 336. The BANK COLLECTION CODE, drawn up by the American Bankers' Association and passed in several states, specifically allowed the charge-back, but at the same time granted full rights of "ownership" to the bank. See, e.g., the Missouri code interpreted in Farmers' Exchange Bank v. Farm & Home Savings & Loan Ass'n, 332 Mo. 1041, 61 S.W.2d 717 (1933). Compare Steffen, supra note *, in which the A.B.A. code received heavy criticism. Selective elimination of the charge-back has been recommended to shift the risks of check collection losses resulting from bank failure and negligent handling to the banks themselves. Steffen, id. at 556-8, 561-5; Turner, supra note *, at 906; NAT'L CONF. OF COM'MRS ON UNIFORM STATE LAWS, HANDBOOK 182-3 (1934).

19. See Frye, supra note 2, at 414: "Will the refusal to recognize the bank as a holder in due course under such circumstances restrict the currency of bills and notes? There seems to be no reason why it should have such an effect since in no case can the bank lose the amount of the note. The fact remains, however, that the bank which discounts the note may thus be deprived of the profits of its bargain."

It is doubtful that the bank even loses the profits. In Port Washington v. Polonia Phono. Co., 180 Wis. 71, 77, 192 N.W. 472, 475 (1923), it was held that the bank may charge back the amount of the note "... with the then accrued interest ..." With regard to checks, of course, the "profits" issue is non-existent.

20. The argument that the value per se rule, by according complete protection, would enhance negotiability has frequently been urged. See, e.g., Comment, 33 YALE L. J. 629, 635-6 (1924); Note, 77 U. or PA. L. REV. 690, 692 (1929). Lack of necessity is the usual reply of courts who reject the doctrine. See note 16 supra.

The rule has also been supported by appeals to logic and consistency. (1) Its consonance with N.I.L. § 25 has been noted. Beutel, supra note 3; Notes, 26 Mich. L. REV. 209 (1927), 80 U. or PA. L. REV. 1159, 1160 (1932). (2) It is urged that there is no lesser risk in extending credit than where an instrument is taken as collateral for an antecedent debt. Comment, 33 YALE L. J. 629, 634-6 (1924); Note, 80 U. or PA. L. REV. 1159, 1160 (1932). (3) It is suggested that "if the bank had given dollar bills for the instrument, which were immediately redeposited, there is no doubt that even the majority of courts would consider it value." Id at 1159; Notes, 26 Mich. L. REV. 209, 210; 77 U. or PA. L. REV. 690, 692 (1929), Nat. City Bank of St. Louis v. Macon Creamery Co., 46 S.W.2d 127, 130 (Mo. 1932).
tection to the extent accorded by the alternative rules, any one of which may make the bank a holder for value even though the depositor's balance at the
time of real or prospective dishonor is adequate for a charge-back. Banks
would have adequate security even if extension of credit were deemed value
only where depositor's balance at time of notice was less than the amount of
the instrument. Thus, with regard to banks, it makes little difference which
of the more inclusive rules is selected.

While additional protection is of minor importance, it has been argued that
making the bank a holder for value is actually undesirable in that it permits
inequitable recoveries against injured makers or drawers, deceived by the
bank's depositor. This criticism has been leveled chiefly at the value per se
rule, but it applies also to the current rules and the compromise proposed
by the Code, which, as noted above, may permit recoveries against a maker even
though a charge-back is possible. Moreover, the validity of the criticism is
highly doubtful, for it is very unlikely that a bank would undertake the
burden of litigation in preference to charging back, unless perhaps as a favor
to an influential customer. And even though a bank's status as holder in due
course might result in recovery from an injured maker, there is equal reason
to believe that by facilitating suit the privilege might persuade a bank to re-
lieve a depositor, accused but not guilty of bad practice, from the charge-back
burden.

None of the arguments is persuasive. The ambiguity of the N.I.L. has already been
noted. See notes 3 and 4 supra. The second argument, even if the similarity in risk with
the collateral security transaction is granted, gives no ground for concluding that either
should constitute value. The dollar-bill analogy, aside from the fact it presents an un-
likely hypothetical, overlooks the loss of control over funds involved in paying out cash;
and query—if the two current rules are so burdensome, why have not banks adopted this
subterfuge?

21. This may be illustrated by an extreme case. Transferor, whose account is at zero,
indorses over to his bank X's note for $1,000.00, payable 90 days hence. He immediately
withdraws the credit given in exchange for the note, and his account remains at zero for
89 days. On presentment of the note by the bank, X replies that he was defrauded and
will not make payment, but on the same day the transferor deposits $1,000 in cash at
the bank. The bank could recover on the note by charging back, but under any of the
current or proposed credit-as-value rules it is a holder for value and could sue the maker
free from his defense of fraud.

And see Steffen, supra note *, at 561: "... as a matter of policy why should [we] be
anxious to aid a banker who has merely given credit for an item, as against a maker who
has been defrauded by the bank's customer? Surely it is not too much to ask the banker
in such case to charge the item back to the wrong-doer and forego collection from the
victim."

23. Another possible criticism of the value per se rule is that the protection accorded
will weaken the bank's proclivity to investigate carefully the status of transferred paper,
particularly time notes—i.e., that the rule will contribute to lax practice. It is probable,
however, that investigation is conducted not only to prevent loss but to prevent future lit-
gation, a function unaffected by the value per se rule. Again, it should be noted that the
With the charge-back established, therefore, there is little reason for preferring any of the current or proposed rules on grounds of protection to banks or of fairness to other parties. Unless there be a moral aversion to granting banks even a paltry gift, it is suggested that a uniform principle should be selected on the basis of simplicity. On this ground, the rule that bank credit constitutes value per se is clearly superior.

**Allocation of Risks in Foreign Remittance Transactions: The Commercial Code**

**Article IV, Chapter II**

A device frequently employed to transmit funds to other countries is the foreign remittance, by which a remitter contracts with a domestic bank to have that bank's correspondent in another country pay money to the remitter's foreign creditor. This transaction is usually undertaken at the remitter's peril: generally it is he who must bear losses caused by depreciation of the foreign currency in which a remittance is expressed, by negligence of the bank's correspondent, by insolvency of that correspondent, and by insolvency of the domestic bank itself.

But decisions have not always placed these risks on the remitter. For this reason, metropolitan banks have sought protection by inserting in their remittance contract saving clauses disclaiming liability for its noncompletion. Even criticism, if valid, applies to alternative rules as well, insofar as they too grant "unnecessary" protection to the bank.

24. The charge-back is sanctioned in the proposed Code, specifically with respect to checks and by implication with respect to other types of paper. A.L.I., Commercial Code Art. III, §§ 715, 720.

1. Banks are by no means the only agencies which a remitter may select as the intermediary through which to make foreign remittances. See, e.g., Whitaker, Foreign Exchange 58 (2d ed. 1933). In this Note, however, the intermediary will be referred to as the "bank" both for the sake of brevity and because most such transactions actually are handled through banks.


3. The metropolitan banks naturally do not attempt to avoid liability for loss due to their own insolvency. Nor do they try to contract against liability on a bill of exchange for the insolvency of their correspondents, since warranty of payment upon presentment ordinarily is made by any drawer of a check or bill (Negotiable Instruments Law, § 61).

The following paragraph, appearing on the back of the cable-transfer contract form of
this device has not been wholly successful, however, for courts occasionally refuse to uphold these clauses.\(^4\)

In an effort to bring about uniformity in this field, the Commissioners on Uniform State Laws have included in their proposed Commercial Code provisions which standardize rules of risk distribution and drastically restrict saving clauses.\(^5\) This task involves reconciling two opposing considerations. On the one hand, the profit derived by the metropolitan banks from handling foreign remittances is so slight that they might be unwilling to offer the service without some means of avoiding these losses.\(^6\) On the other hand, the remitter is usually in an inferior bargaining position and is far less able to spread losses.\(^7\) The extent to which the Commissioners have achieved a balance of these fac-

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6. The metropolitan banks handle foreign remittances principally as a service to their customers. Whatever profit they make ordinarily no more than compensates them for expenses incurred in rendering other foreign services (*e.g.*, credit reports) to their domestic customers. Communication to the author, from George B. McGowan, Vice President, Corn Exchange Bank Trust Company, April 23, 1948, in Yale Law Library. For discussions of ways in which banks might profit from foreign remittances, see *Southard, Foreign Exchange Practice and Policy* 36 et seq. (1940) (suggesting that banks can profit on the overall spread between the “buying” and “selling” exchange rates); *Note, 12 Calif. L. Rev. 209, 212 (1923-24)* (suggesting that profit can be made on exchange and from the free use of remitter’s money while the remittance is being consummated).

7. Almost all foreign-remittance transactions are funnelled through the large banks in metropolitan centers, primarily those in New York. *Southard, op. cit. supra* note 6, at 36.

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"This cable transfer is for the payment of money in the amount named on the reverse side hereof, and it is agreed that this transaction is to be construed as a present sale of such money. It is further understood and agreed that the Guaranty Trust Company of New York shall not be responsible for error, delay or default of any kind in the transmission of messages in execution of this order by telegraph, cable or wireless companies, or foreign government telegraph services or of letters, post remittances or drafts by the post office of this or any foreign country, or by any express company, nor for the acts or omissions of the correspondents or agencies employed by it in ordinary course in the further transmission and/or final payment of this order, nor for the failure of such correspondents or agencies to identify the payee in making payment, nor for any cause beyond its or their control; but the risk of loss or damage resulting from any such errors, delays, or defaults, cause, acts or omissions of failure to identify the payee is assumed by the purchaser. Refund will be made if payment of the order has not been effected to the payee, except where there has been a failure of identification in making payment, at a rate not in excess of the market rate prevailing at the time when the Guaranty Trust Company of New York receives notice of such non-payment and thereafter has instructed its foreign correspondents to cancel said order and has received confirmation of such cancellation."

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tors may be considered by observing what allocation the Code would make of typical foreign-remittance risks.

The problem of allocating the risk of currency depreciation was before the New York Court of Appeals in *Kerr Steamship Company v. Chartered Bank*. In November, 1941, the plaintiff "bought" a foreign bill of exchange, payable in Philippine pesos, drawn on the defendant bank's correspondent in Manila. The supervening Philippine invasion prevented delivery, and the bill was returned to the plaintiff. Since the dollar value of the peso had plummeted almost to zero, the defendant refused a refund. The plaintiff sued in rescission to recover the purchase price of the bill, relying largely on *Gravenhorst v. Zim-werman*. In that case, a cable transfer had been classified as a mere executory contract for the sale of foreign credit, entitling the remitter to rescind for noncompletion of the remittance and to recover his purchase price in full. But the court distinguished the *Gravenhorst* ruling on the ground that a bill of exchange is essentially different from a cable transfer and held that the transaction in question was an executed sale of pesos not subject to rescission.

The *Kerr* and *Gravenhorst* cases raise the bewildering question of who should bear depreciation loss when neither party is responsible for noncompletion. But an answer based solely on the forms of remittance instruments used ignores their functional similarity. The factual backgrounds of the cases, however, suggest that the decisions may be less unrealistic than their language.

The denial to the *Kerr* plaintiff of the full recovery allowed the remitter in the *Gravenhorst* case may be explained by the difference in speed between the particular forms of remittance employed. Thus, discretion might have indicated to the *Kerr* plaintiff, at the time of sale, that transmitting a remittance draft by airmail at a time when war threatened was far more hazardous than the more rapid, albeit slightly more expensive, means of a cable transfer, which would have arrived in time. For the remitter was a large operator, in fully as favor-

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9. While this process is frequently referred to as the "sale" of a remittance, such a designation can be misleading. See note 12 infra. Regardless of label, it is a transaction whereby one party pays money in order to achieve a payment to a foreign beneficiary and the other party agrees to do certain things to accomplish that payment.


11. The opinion suggested, however, that the issue of a bill of exchange would have been an executed sale. Id. at 31, 139 N.E. 769.


The business practice is to treat the different forms of remittances as essentially alike. For example, a letter from Arthur Kolmodin, Assistant Manager, Foreign Department, The Chase National Bank of the City of New York, indicates that the metropolitan banks consider remittances by foreign bill of exchange and by cable transfer as differing only in speed of transmission. Communication to the author, April 27, 1948, in Yale Law Library. This one difference may sometimes be significant, however. See text infra.

13. The steamship company instituted the remittance on November 28, 1941, by which date it is probable that a large shipping firm operating in the Pacific had inklings that trouble was brewing. For a relatively paltry sum the company could have used a cable
able a position to anticipate an interruption of commercial intercourse as the bank. Furthermore, the draft had been drawn on an existing foreign account from which the defendant bank could have disposed of the pesos in time by cable had they not already been sold to the remitter. On the other hand, the remitter in the Gravenhorst case tried to secure the most rapid transmission possible, but the fastest was not fast enough; and in that case the bank could not have disposed of its marks. Accordingly, a difference in result based on the form of remittance may be justified in the unusual circumstance where speed is a crucial factor and the remitter has been is a position to realize its importance.

The refusal to award even partial recovery to the Kerr plaintiff at any exchange rate prevailing between the time of noncompletion and the time of trial may be explained by the absence of any market for the peso during that period. Hence, despite the court’s apparently unqualified statement of its holding, there is no certainty that it would have left the remitter without remedy if the pesos had retained a significant percentage of their purchase-price value and if the remitter had framed its complaint to take advantage of this fact.
Adopting a middle ground between the all-or-nothing propositions asserted in the Kerr and Gravenhorst opinions, the Commissioners propose to allocate the risk of currency depreciation without regard to the form of remittance.\(^1\)

In the situation where neither party is responsible for noncompletion, the Code seeks to provide for a refund to the remitter at an exchange rate approximating the rate prevailing at the time of noncompletion.\(^2\) This position is justifiable where the bank has immediately set up the remittance in terms of the foreign currency and where the remitter is a big concern which is well-informed on world conditions, as in the Kerr case. Under these circumstances, adoption of the Gravenhorst rule that the remitter can recover in full would be unnecessarily hard on a bank which for reasons beyond its control is left with depreciated currency on its hands. Especially since insurance against currency fluctuations seems not to be available\(^3\) and since banks do not make a practice of speculating in foreign currencies, the banks under such a rule would certainly hesitate, if not refuse, to handle any foreign remittances not expressed in dollars. In two respects, however, the refund rule proposed in the Code may work injustice. If the bank arranges to postpone setting up the remittance in terms of the foreign currency until after the remittance has been completed,\(^4\) the pro-

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18. COMMERCIAL CODE Art. IV, Chap. 2, § 1(1).
19. Id. §§ 9, 11. The Code draws a sharp distinction, in this situation, between the refund rate where the remitter cancels the remittance and the rate where the bank fails to perform. In the former case, the Code measures the refund at the exchange rate current when the bank has notified the remitter of "compliance with [his] stop order." § 11(1) (b). In thus placing the risk of depreciation on the cancelling remitter until the bank can protect itself, the Code treats a faultless remitter who cancels because completion has become impossible the same as a remitter who cancels for reasons of his own convenience. See §§ 9(2), 11(1) (b); cf. Simonoff v. Granite City National Bank, 279 Ill. 248, 116 N.E. 636 (1917).

In the case where non-completion is the result of the bank's failure to perform for reasons not at its risk—as where the bank is prevented by the outbreak of war from setting up the credit with a correspondent—the Code measures the refund at the exchange rate current when the remitter is notified of non-completion. See §§ 9(1) (a), 11(1) (c).

Thus, for the purposes of refund where neither party is responsible for a failure to complete the remittance, the Commissioners have taken as the point of non-completion the time when the remitter is notified that the bank is no longer in a position to perform its contract. If the reason for the more or less arbitrary selection of this particular instant of time to enable the bank, where possible, to protect itself by reversing the credit set up in favor of its correspondent, the Commissioners might have dispensed with the additional requirement of notification to the remitter. In most cases, however, any difference in the amount of the refund will be negligible since the Code provides that "against any party whose fault has caused delay in notifying the party entitled to . . . refund . . . , the latter may at his option choose the [exchange] rate current at the time when he should have been notified." § 11(2).

21. The bank, for instance, might have a standing arrangement with a correspondent
posed rule would give the bank a windfall equal to the difference between the
original price and the refund. And it seems questionable whether the Commis-
sioner's position on refunds is justifiable in the case of the petty remitter who
has neither the facilities for securing advance warning of threatening disturb-
ances nor means with which to pay for speedier service.

The second major hazard to the remitter may be illustrated by a situation in
which he instructs the bank to arrange payment abroad, and the bank's corre-
respondent receives the credit and the instructions but negligently acts in such a
way as to defeat the remitter's purpose—for example, in paying out the money
to a person whose name is similar to that of the beneficiary, or in failing to
notify the beneficiary in time for him to consummate a business deal. The
remitter demands a refund or damages. But the bank stands on the clause in its
contract protecting it from such liability and advises the remitter to seek his
remedy against the correspondent or against the recipient of the funds.

The Code would place on the bank none of the burden of losses due to a
correspondent's negligence. But the desirability of this provision seems
doubtful, especially since banks might be able to arrange insurance against
some of these losses. If the remitter is deprived of remedy against the bank,
he is in most cases left without any remedy: only large remitters can afford
to pursue an action abroad, and under the law of many countries the corre-
spondent's obligation may be discharged by payment to the wrong party. It
is little comfort to the remitter to be told, as he has been in at least one
decision,25 that he must look to the negligent correspondent rather than the
metropolitan bank because the Massachusetts rule on subagency applies to
his case. Whatever may be the merit of extending to foreign-remittance cases
a rule developed for application to domestic bank-collection transactions, the
fact remains that the foreign subagent may be 5,000 miles away. To be
sure, banks will press their correspondents to make good to their customers,

whereby the latter honors all drafts drawn upon it by the bank, and the bank credits the
correspondent's account upon notice that the draft has been paid.

23. Communication to the author, from F. A. Nelson, for Marsh & McLennan, Inco-
porated, April 29, 1948, in the Yale Law Library. After explaining that this protection is
not generally available, Mr. Nelson goes on to say: "It might be possible in certain cir-
cumstances to insure the legal liability risk. There are no rates available, as this would
generally be considered a business risk. The selection of a correspondent and his financial
stability would be the medium of consideration."

1911).
Dec. 59 (1839).
27. For an argument that the situations are not sufficiently similar, see Seawell, J.,
dissenting in Nicoletti v. Bank of Los Banos, 190 Cal. 637, 648 et seq., 214 Pac. 51, 55 et
seq. (1923).
but the incentive would be much stronger if the bank's own interest were at stake.

The objection to imposing liability on the bank in this situation is the insufficient-profit argument. But on large remittances, the profit resulting from the spread between the rates at which banks buy and sell currencies may be sufficient to cover this risk without higher charges. And even though an increased rate is necessary, as it probably would be on smaller transactions, all remitters might well prefer to pay higher charges in order to obtain this guaranty rather than to have lower charges with the risk of irretrievable loss due to a foreign agency's negligence. Banks might protest that it would be impossible to develop a world-wide network of completely reliable correspondents and that consequently, if made responsible for the correspondent's negligence, they would be unable without instituting prohibitive charges to handle remittances to countries which do not have trustworthy banking systems. But query whether a distinction could not be made by permitting saving clauses in contracts for remittances to certain countries while still prohibiting them in remittances to such financially well-developed countries as, for example, Canada?

The third risk which the remitter must bear is that the foreign correspondent will become insolvent after receiving the credit with the metropolitan bank but before paying the money to the beneficiary. The bank again points to a saving clause expressly disavowing its responsibility for such a loss, and the remitter finds that he has exchanged his money for a position as a general creditor of an insolvent bank far away.

Metropolitan banks have never been considered guarantors against the insolvency of their foreign correspondents on any form of remittance other than a bill of exchange. But the Commissioners contemplate imposing in all foreign-remittance cases the liability of a guarantor, which banks already bear in domestic transactions. In doing so, they justifiably vary the duration of the guaranty for different types of remittances. In the case of

28. See note 6 supra.
29. Apparently this profit on the spread between buying and selling rates is not unreal; a large Chicago bank's schedule of remittance charges shows that no charge is made on remittances of over $500.
30. A difficulty with this argument is the problem of devising a rational method of deciding which countries are sufficiently "well-developed."
31. Clearly the banks are liable, on bills of exchange, for their correspondents' insolvency. See note 3 supra. No case has been found, however, holding a bank thus liable on any other form of remittance.
32. COMMERCIAL CODE Art. IV, Chap. 2, § 7(1).
34. COMMERCIAL CODE Art. IV, Chap. 2, § 7(1).
drafts, for example, the bank should not bear the risk of supervening insolvency of the correspondent after the draft could reasonably have been presented. But even though insurance against this risk is not available, holding the bank liable is certainly fair to the extent that the bank can protect itself by careful selection of correspondents or by withholding credit until actual payment is made.

Withholding of credit, however, may be prevented by foreign currency regulations, which in many instances force domestic banks to give immediate credit in cases of dollar remittances. In such a case the risk is fairly borne by the remitter, but he in turn should be given a pro tanto priority in any set-off which the bank may have against the insolvent correspondent; and this is tentatively the view of the Commissioners. The bank's immunity from liability, however, should be conditioned upon a clear warning to the remitter of the risky consequences of expressing a remittance in dollars.

Finally, the risk of the metropolitan bank's insolvency may put a remitter in this predicament: he pays a metropolitan bank which, after crediting the correspondent and sending it appropriate remittance instructions, promptly closes its doors. The bank receiver cancels the correspondent's credit, thereby preventing consummation of the remittance, and takes the position that the remitter is a general creditor of the insolvent bank.

Although federal deposit insurance legislation apparently does not pro-


36. Such regulations, promulgated by many foreign governments eager to conserve precious dollar reserves, attempt to accelerate and to make more definitely ascertainable the date at which dollar credits will become available to their national economies. Communication to the author, from George B. McGowan, Vice President, Corn Exchange Bank Trust Company, May 14, 1948, in the Yale Law Library.

The necessity for advance credits may arise also from refusal on the part of foreign banks themselves to make payment until they receive credit. Their reasons for such action might include the risk of the insolvency of the crediting bank, uncertainty of collection due to undependable or disrupted communication channels, and the difficulty of estimating what exchange rate to use in a rapidly fluctuating money market. Ibid.

37. COMMERCIAL CODE Art. IV, Chap. 2, § 7(2).

38. This can be done by conspicuous notice in the remittance contract, in much the same way, for example, that the following paragraph in the Corn Exchange Bank Trust Company's dollar-remittance contract informs the remitter about foreign currency regulations:

"IMPORTANT NOTICE TO REMITTERS

"If the remitter prefers to have the Trust Company withhold credit from the Foreign Bank, of the U. S. Dollar principal amount, until receipt of the Trust Company of notice of execution of payment, the Trust Company will accept this transaction on that basis; but it must be understood that the Foreign Bank, to which instructions to pay are sent may refuse to make payment until credit is given because of governmental regulations or for other reasons, and the withholding of credit might thereby cause an otherwise avoidable delay in effecting payment. If the remitter is content to risk such delay, instructions to withhold credit should be given on the reverse side of this contract."

tect the remitter in this situation, he is normally unable to secure the status of a preferred creditor. To be accorded such a position, he must establish either that the bank holds the remitter's funds as trustee for the remitter, or that the bank has given to the remitter an equitable pro tanto assignment of its account with the correspondent. But the weight of authority is against solution of this problem under a trust theory. And the Supreme Court has indicated that, except in unusual circumstances, an equitable assignment may not be implied in a remittance transaction. The issue was raised in *Equitable Trust Company v. First National Bank of Trinidad* by the claim of an inland bank to a preferred position over the general creditors of an insolvent metropolitan bank. The claim was based on a remittance transaction in the course of which the bankrupt had instructed its foreign correspondent to honor the claimant's bill of exchange out of funds held to the bankrupt's credit. The Court assumed that such a transaction would have effected an equitable assignment had the parties so intended; but held, Mr. Justice Stone dissenting, that the local bank was merely a general creditor because "the practice in international banking," in the light of which the parties were presumed to have contracted, permitted the metropolitan bank to reverse credit extended to its correspondent whenever it "saw fit to do so."

If the case turned merely upon this nebulous question of banking custom, it might have far-reaching implications. For Judge Learned Hand, holding in the court below that the remittance transaction constituted an assignment, noted that the banking custom privileging reversals of credit did not extend beyond the practice of reversing credit whenever a remittance is can-

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42. 275 U.S. 359 (1928).
43. A type of contract still in use today. See, e.g., drawing instructions of The Chase National Bank of the City of New York, version current in April, 1948, p. 1. The contract of the metropolitan bank in the Trinidad case provided that "Upon receipt of advice of draft...we shall promptly forward our advice of the same and provide the drawee with funds sufficient for the payment of the draft abroad, by a transfer of credit from our balance, or otherwise..." *Equitable Trust Company v. First National Bank of Trinidad*, supra note 42, at 365.

The contract was an integral part of an "indirect remittance" transaction. See Commercial Code Art. IV, Chap. 2, § 8. In such a transaction the remittance is purchased from a local bank without foreign correspondents. The bank in turn arranged with a metropolitan bank for the use of its foreign credit facilities through a contract such as the one here employed.

44. Trinidad case, supra note 42, at 366 et seq.
45. Id. at 369 et seq. (dissenting opinion).
46. Id. at 366.
47. In re Gubelman, 13 F.2d 732 (2d Cir. 1926).
celled. This observation suggests that the Supreme Court’s failure to prefer the local bank over general creditors may be discounted as the result of an erroneous factual interpretation. But even should the banking custom of reversing credits be re-examined in the light of Judge Hand’s opinion, it does not follow that the ordinary remitter would always be able to secure the status of a preferred creditor on an assignment theory. In the Trinidad case, the metropolitan bank held with its foreign correspondent an existing credit balance which could be regarded as assigned, in part, to the claimant. Suppose, however, that the transaction instead of reducing the amount of this credit balance resulted in a debit balance, or that no credit balance existed at the time of the original contract. Where the correspondent owes nothing to be assigned, an assignment cannot be spelled out, however plausible it may seem in the case of an account actually owing to the metropolitan bank. Yet under modern banking practice whether an ordinary foreign remittance transaction results in a net credit or net debit balance in the metropolitan bank’s account with its correspondent seems purely fortuitous. Only in the unlikely event that a remittance is expressed in an amount exactly equal to a credit balance in that account can it be reasonably argued that a specific allocation of the account was within the contemplation of the parties. Except in this unusual circumstance, therefore, the equitable assignment doctrine seems an inadequate basis for classifying a remitter as a preferred or general creditor.

The section of the Code describing the Trinidad-type of remittance contains no provision clarifying the nature of claims against an insolvent metropolitan bank. An apparently related section, however, provides that “Where a bank has credited the account of another bank carrying an account with it on instructions that the credit is . . . for the benefit of or on order of one or more named parties, . . . such a credit creates no trust or interest in the account in favor of the instructing party or of any other person named in the instructions. . . .” Clearly the Commissioners intend in the circumstances treated in the latter section not only to codify the majority view against the use of a trust but also to proscribe the use of an equitable assignment as a device to give the remitter preferred-creditor status. It must be assumed that the principle expressed is broad enough to cover all remittance transactions.

It is to be regretted, however, that the Commissioners, having disposed of the equitable assignment doctrine, did not go further to reconsider

48. Id. at 735.
49. COMMERCIAL CODE Art. IV, Chap. 2, § 8.
50. Id. § 12.
51. It is not entirely clear what remittance transactions are intended to be embraced by § 12. In the comments accompanying an earlier version of the Code, Tentative Draft No. 1, § 12 was discussed as applying to the following type situation: N Bank in New York, carrying accounts for S Bank in Stockholm and R Bank in Rio, is instructed by S Bank to credit the account of R Bank for the benefit of X.
initio the relationship of a remitter with the bank from which he has purchased a remittance. If Judge Hand correctly interpreted banking custom as denying to a bank the privilege of reversing credit once set up in favor of a remitter unless the remittance is cancelled, then it may be argued that the bank has so lost control of the credit and the transaction has so nearly approached completion that the funds of the remitter are beyond the reach of the bank's creditors. Particularly when the remitter is not covered by federal deposit insurance, the Code might well provide in this instance for his protection.

Although foreign remittances are likely to be subordinate in importance to letters of credit until exchange restrictions are relaxed, they may be expected to increase with restoration of world stability and rehabilitation of international trade. The lack of uniformity and predictability in litigation concerning this device may best be remedied by a positive legislative program, such as that of the Commissioners. It is submitted that whatever program is adopted should be predicated upon the basic similarity of all forms of remittances as between bank and remitter and upon the desirability of placing the risks on those parties in the best position to spread any resulting losses.

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52. It is realized that such a transaction has not yet reached final completion in the sense of Commercial Code Art. IV, Chap. 2, § 5(1) (b), which provides that a remittance may be completed "by establishment of a . . . credit in favor of the remittee if so agreed by the parties . . .," and that "a credit is established in his favor when he receives notice that the credit is available to him as of right."

53. See Southard, op. cit. supra note 6, at 126 et seq.

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