GUARANTIES AND THE SURETYSHIP PHASES OF LETTERS OF CREDIT *

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VI. SURETYSHIP IN TRANSACTIONS INVOLVING LETTERS OF CREDIT

In a situation where the issuing banker promises to pay the purchase price of goods, either directly or through the medium of a draft, the requisites of a suretyship relation are generally present. The first requirement is that the banker and the buyer of the goods be each bound to a third person; they may be thus bound to the seller, the banker by virtue of the letter of credit and the buyer because of the contract of sale;[138] also they may be bound to a purchaser of the draft drawn and negotiated by the seller, the banker because of the letter and the buyer through an implied or equitable assignment of the seller's contractual right. The fact that buyer and banker are severally and differently bound does not exclude the relation of principal and surety. Whether the banker is surety for the buyer or the reverse relation exists depends on the agreement between them or, in the absence of an agreement, on what equity and good conscience requires. Several situations may be considered. In the first place, if the buyer agrees to put the banker in funds with which to pay the draft on or before its presentation for payment, the banker is surety and the buyer principal; for by their agreement the latter is to provide the funds for payment in ease of the former. Secondly, if the buyer in the beginning puts the banker in funds for the purpose of meeting the draft on presentation, it is obviously the banker who should pay it in ease of the seller; here the banker is principal and the buyer surety. That the latter happens to be a general depositor, however, is not equivalent to the banker's being placed in funds for paying the draft, even though he may have the power of charging the amount of the draft against the buyer's account on payment or on the buyer's default; the reason is that in the meantime the banker is bound to honor the buyer's checks drawn in favor of other persons notwithstanding liability on the letter of credit. Thirdly, if the arrangement is that the banker shall pay the draft by way of making a loan to the buyer, and that

* The first installment of this article, containing footnotes 1-137, appeared in the December issue of the REVIEW. (1936) 85 U. OF PA. L. REV. 175.

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138. The accrual of an enforceable right on the letter, or the later acceptance of a draft, results in no more than conditional satisfaction of the buyer's contractual obligation to the seller. See *infra* note 146.

the latter shall thereafter repay the amount thereof with interest to the former, as between the two the banker should pay the draft on presentation out of his own resources; hence he is principal and the buyer is surety.[139]

The importance of determining the relation between buyer and banker becomes apparent in several situations:

(1) If the banker is principal, his promise to the seller of goods or to the purchaser of the draft is not within the Statute of Frauds and is actionable though oral.[140] On the other hand, if the banker is surety, his promise, though primary in form, is within the Statute and, if oral, is non-actionable,[141] except in the rare case where the seller of goods or purchaser of the draft, as the case may be, reasonably believes the banker to be the principal.[142]

(2) Another difference exists in respect to security rights acquired by the banker in the buyer's property, that is, in documents of title delivered over to the banker on acceptance of the draft or in additional security deposited by the buyer. If the facts are such that the banker is surety for the buyer, the familiar American doctrine, that a creditor is equitably entitled to security rights obtained by the surety in the property of the principal for the surety's exoneration or even for his reimbursement, affords valuable protection to the seller of goods or the purchaser of a draft, as the case may be, in the event of insolvency of the issuing banker.[143] On the other hand, if the undertaking between issuing banker and the buyer is that the former shall make payment by way of a loan to the buyer, and security is given merely for repayment of the loan, then the seller of the goods or purchaser of a draft has no equity in the security; for its proceeds are not to be used for paying the seller (or the purchaser of the draft) but only later and in the event of default in repaying the banker.

(3) Yet another suretyship problem is raised by the insolvency of the issuing banker.[144] Thus, in *Bank of United States v. Seltzer*,[145] the plaintiff, a bank in New York City, had issued a letter of credit to the defendant, a merchant in the United States, to facilitate the importation of silk from Japan, the defendant having agreed to place the plaintiff in sufficient funds

139. For a further treatment of the suretyship elements involved in letters of credit see Finkelstein, Legal Aspects of Commercial Letters of Credit (1930) 32, n. 22; McCurdy, *Commercial Letters of Credit* (1922) 35 Harv. L. Rev. 715, 737.

140. Springfield Marine Bank v. Mitchell, 48 Ill. App. 486 (1892). The case, however, is open to criticism on another ground. See 85 U. of Pa. L. Rev. at 187, sub-topic II.

141. The writer submits that this statement represents the better view. Many divergent authorities may be found in Finkelstein, *op. cit. supra* note 139, at 33, 34.

142. Jarvis v. Wilson, 46 Conn. 90 (1878). *Contra:* Manley v. Geagan, 105 Mass. 445 (1870). See 1 Williston, Contracts (2d ed. 1924) § 458, nn. 58, 59.

143. Muller v. Kling, 149 App. Div. 176, 133 N. Y. Supp. 614 (1st Dep't, 1912), *aff'd*, 209 N. Y. 239, 103 N. E. 138 (1913), might well have been rested on this ground rather than that of an implied agreement for security made directly with the purchaser of the draft.

144. For authorities see Note (1932) 80 A. L. R. 803.

145. 233 App. Div. 225, 251 N. Y. Supp. 637 (1st Dep't, 1931).

to pay the draft one day before its maturity. In pursuance of the letter of credit, the seller drew a ninety-day draft and negotiated it to a Japanese bank with the required shipping documents attached; the draft was later accepted by the plaintiff bank but not paid because of its intervening failure. The shipping documents had been surrendered to the plaintiff on acceptance of the draft and immediately delivered over by it to the defendant in return for a trust receipt requiring the defendant to pay the proceeds of the sale of the silk to the plaintiff bank to be applied on its acceptance. The defendant seasonably offered to pay to the plaintiff the amount of the draft, with interest, commission, and expenses, on condition that the plaintiff first pay the draft to the holder or else hold the amount in trust for that purpose. The plaintiff refused the offer. The defendant then paid the draft supra protest to the Japanese bank. In this action brought to recover the amount of the draft, with the evident intention of swelling the general assets of the insolvent plaintiff bank, judgment was properly rendered for the defendant.

At the very outset one must inquire whether the buyer remained bound to the seller on the contract of sale. It is conceivable that in a particular case a novation of obligors is intended and effected when the seller complies with the letter of credit by shipping the goods, or at least when the issuing bank accepts the draft. Nevertheless, in most situations, compliance with the letter and the accrual of an enforceable right to the seller thereunder would seem to involve no more than a conditional satisfaction of the seller's right against the buyer.[146] No reason appears why the seller would gratuitously and irrevocably part with this second string to his bow. Nor is there any reason why the buyer should object to its continuance; for non-performance on the part of the seller would relieve the buyer from liability to the seller and to any assignee of the latter's non-negotiable right; and payment of the draft by banker or buyer would discharge the non-negotiable right whether previously assigned or not.[147] Nor should acceptance of the draft by the issuing bank change conditional satisfaction to absolute satisfaction, for, the shipping documents being then delivered over, the holder of the draft and the seller, who is secondarily liable to him, are more than ever in need of the responsibility of the buyer. Hence there is no presumption and usually no inference of absolute satisfaction in this situation.[148]

146. See Second Nat. Bank v. Columbia Trust Co., 288 Fed. 17, 23 (C. C. A. 3d, 1923); Greenough v. Munroe, 53 F. (2d) 362, 363 (C. C. A. 2d, 1931) (reasoning); *In re* Canal Bank & Trust Co.'s Liquidation, 178 La. 575, 587, 152 So. 297, 300 (1933) (reasoning); Lamborn v. Kirkpatrick & Co., 288 Pa. 114, 119, 135 Atl. 541, 543 (1927). See also Note (1926) 40 Harv. L. Rev. 294.

147. It seems that the effect of conditional satisfaction is the same here as in other cases: pending default in performance of the new promise, action on the precedent debt or obligation is suspended; if the new promise be performed (here by payment of the draft), the prior debt or obligation is extinguished; if not performed, it stands as an additional means for enforcing payment of the debt or obligation.

148. See Bassett v. Leslie, 123 N. Y. 396, 399, 25 N. E. 386, 387 (1890) (reasoning; buyer denied interpleader against seller and transferee of a counter draft drawn by the issuing

Indeed, in most cases now under consideration, beneficial ownership of the goods passes to the buyer on delivery to the carrier [149] and the buyer then becomes indebted to the seller for the purchase price, the latter retaining legal title by way of security therefor.[150] Consequently, the seller is aided in most jurisdictions by the prima facie presumption of law that a negotiable order or promise, whether given by the debtor or a third person (as was the acceptance here), is delivered and received only in conditional satisfaction of the antecedent debt.[151] And even in the less frequent situation where beneficial ownership of the goods does not pass until delivery by the carrier to the buyer, or until acceptance of the draft, the seller still would seem not to be struck by the contrary prima facie presumption that a negotiable instrument payable to the seller, executed by a stranger and not indorsed or guaranteed by the buyer, is received in absolute payment of the presently-created debt; [152] for the accepting bank is not a stranger because it was already obligated to accept and pay the draft. This is not a case where a seller may be supposed to accept the obligation of another person in lieu of cash, but rather one in which the seller is merely taking what the letter of credit entitles him to.

It having been thus demonstrated that the buyer remained bound to the seller, the several conceivable grounds for the decision in *Bank of United States v. Seltzer* may be next considered: (1) The ground relied on by the court: that there is prospective failure of consideration arising from the inability of the plaintiff, the issuing bank, to perform its express or implied promise running to the defendant, the buyer, to pay as well as to accept the draft and thus indirectly relieve the defendant from paying the contract price of the goods to the seller or the Japanese bank.[153] All the more is this true if the issuing bank has dishonored its acceptance when it brings action

bank and accepted by the buyer); Leslie v. Bassett, 129 N. Y. 523, 526, 29 N. E. 834, 835 (1892) (reasoning).

149. 1 WILLISTON, SALES (2d. ed. 1924) §§ 282-284.

150. And in cases where a bill of lading running to the order of the buyer is retained by the seller, legal and beneficial ownership passes to the buyer, the seller reserving a lien for the purchase price. *Id.* § 285.

Of course, the understanding between the issuing banker and the buyer may be that beneficial ownership of the document of title and the goods represented thereby shall pass to the banker on acceptance of the draft, and from him to the buyer when the latter puts the former in funds to pay the draft. In such case, if the banker sells the goods before the buyer is in default, the latter is excused from putting the banker in funds, whatever may have been the value of the goods at the time of such sale. Anglo-South American Trust Co. v. Uhe, 261 N. Y. 150, 184 N. E. 741 (1933).

151. The few states recognizing a contrary presumption are Indiana, Maine, Massachusetts, and Vermont. 3 WILLISTON, CONTRACTS § 1922, n. 20.

152. *Id.* § 1922, n. 24. It makes no difference whether the sale takes place without a previous contract to buy and sell. Gibson v. Tobey, 46 N. Y. 637 (1871); New York & Cuba Mail S. S. Co. v. Texas Co., 282 Fed. 221, 223 (C. C. A. 2d, 1922) (due bill of third person given for prepaid freight). Or in pursuance of such a contract. Noel v. Murray, 13 N. Y. 167 (1855) (dictum); Challoner v. Boyington, 91 Wis. 27, 64 N. W. 422 (1895); Hall v. Stevens, 116 N. Y. 201, 207, 22 N. E. 374, 376 (1889).

153. Accord: *In re* Canal Bank & Trust Co.'s Liquidation, 178 La. 575, 581, 152 So. 297, 298 (1933) (reasoning).

against the buyer.[154] In either case, being disappointed in respect to the equivalent bargained for, the defendant may rescind the transaction and thus be excused from performance of his promise.[155] (2) That the promise of the defendant, in view of its purpose and his obligation to the seller, must be interpreted as a promise to put the plaintiff bank in funds *or otherwise exonerate it*,[156] or, at most, to put the plaintiff in funds *in trust* for payment of the draft. If the former interpretation is sound, payment to the holder of the draft constituted full performance of the promise; if the latter, a judgment so limited would not be erroneous.[157] Similarly, in *Bassett v. Leslie*,[158] where, as a method of putting it in funds, the issuing bank drew and the buyer accepted a negotiable draft payable a few days before the maturity of the main draft, and the bank negotiated the subsidiary draft to secure its antecedent debt to Leslie and later became insolvent, it was held that Leslie, not being a holder for value as the law of New York then stood, could not recover from the buyer; first, because of failure of consideration, and secondly because of the wrongful diversion of the draft from its purpose.[159] The latter reason supports the proposition that the subsidiary draft was given in trust as a means of providing funds for meeting the main draft. (3) The first and second grounds which have been suggested are not at all dependent on suretyship. The reason now about to be advanced is based on suretyship and the fact of payment, and would suffice even though the plaintiff bank had remained solvent. The relation of surety and principal between plaintiff and defendant, respectively, is fairly demonstrable; for it seems that the Japanese bank may be regarded as an actual or equitable assignee of the seller's right to the purchase price,[160]

154. See Bassett v. Leslie, 123 N. Y. 396, 400, 25 N. E. 386, 387 (1890) (reasoning); Leslie v. Bassett, 129 N. Y. 523, 526, 29 N. E. 834, 835 (1892).

155. 2 Williston, Contracts § 877. A like principle prevails in the law of bills and notes. A maker of a note given in return for a promise of the payee, which the latter will not be able to perform, may rescind the transaction and so gain a defence to the note not only as against the payee but also against a subsequent holder who knows of the consideration and that it will fail. Russ Lumber & Mill Co. v. Muscupiabe Land & Water Co., 120 Cal. 521, 52 Pac. 995 (1898); Washington Trust Co. v. Keyes, 88 Wash. 287, 152 Pac. 1029 (1915).

156. Sexton v. Fensterer, 154 App. Div. 542, 139 N. Y. Supp. 811 (1st Dep't 1913), *aff'd without opinion*, 213 N. Y. 641, 107 N. E. 1085 (1914). *K*, a New York banking firm, arranged with *E*, a German firm, to honor drafts drawn by *X* and charge them to the account of *K*; defendants "guaranteed payment" of the drafts, their usual practice having been to put *K* in funds, so that *K* could put *E* in funds. *K* becoming bankrupt, defendants put *E* in funds; in this action brought by the trustee in bankruptcy of *K*, judgment was rendered for the defendants on the ground that they were also bound to *E*, and that the payment made to *E* "satisfied" defendants' obligation to *K*.

157. Greenough v. Munroe, 46 F. (2d) 537 (S. D. N. Y. 1931), *aff'd*, 53 F. (2d) 362 (C. C. A. 2d, 1931), *cert. denied, sub nom.* Irving Trust Co. v. Olivier Straw Goods Corp., 284 U. S. 672 (1931).

158. 123 N. Y. 396, 25 N. E. 386 (1890).

159. The court refrained from relying on this reason in Leslie v. Bassett, 129 N. Y. 523, 29 N. E. 834 (1892).

160. "A court wishing to reach this result [liability of buyer to purchaser of draft] might better have done it by using the argument that equity would compel the seller to use his rights against the buyer on the original debt for the benefit of the transferee of the draft. There is some analogy here to the doctrine that in equity the security follows the debt. While it is

the result being that both plaintiff and defendant were bound to the Japanese bank, and as between the two the defendant, by the very terms of its contract with the plaintiff, was responsible for supplying the means of performance. Hence, the defendant being a principal in respect to the plaintiff bank, payment made by the defendant to the Japanese bank discharged the plaintiff, his surety. Plaintiff's risk having ceased and the purpose of the defendant's original contract with it having been fulfilled, the defendant may successfully resist an action thereon.[161] For the same reason, on paying the draft to the holder, the buyer would be entitled to surrender of such security as the issuing bank held, including the shipping documents;[162] or, the shipping documents having been delivered over in return for a trust receipt, the buyer could resist an action brought on the undertaking contained therein and could require surrender and cancellation thereof.[163] (4) The court stated, without making it a ground for the decision, that at all events the defendant could have asserted by way of set-off against the plaintiff a claim against the latter resulting from the payment of the draft supra protest.[164] The fundamental objection is that subrogation is never given in favor of a principal against the surety. The same objection would prevail against an argument that the defendant as an unofficious payer would be subrogated to, and could use as an equitable set-off, the right of the Japanese bank against the plaintiff bank on the letter of credit.[165] Moreover, the acquisition of these claims by the defendant through payment came too late for them to be set off, since the plaintiff was already insolvent and in the hands of the superintendent of banks.[166]

(4) It is conceivable that a binding extension of time might be given by the creditor, that is, the seller of the goods or the purchaser of the draft, to buyer or banker without the other's consent. If the one to whom time is

true that the seller's contract rights against the buyer are not held as security for the payment of the draft, they resemble the case of security in that they are useless to the seller so long as the draft is outstanding in the hands of a third party." Note (1926) 40 HARV. L. REV. 294, n. 25.

161. This argument proceeds, of course, on the assumption that the issuing bank remained a surety. The assumption seems to be justified because the breach of its obligation to the defendant, impending or even completed, would merely relieve the defendant from his duty to put the bank in funds and not impose on the plaintiff, now insolvent, any duty (running to the defendant) to pay the draft in the first instance out of its own funds.

162. Provided, of course, that by agreement between them the shipping documents do not secure other unpaid indebtedness of buyer to banker. It is all the clearer that in such a situation the issuing bank is not obliged to surrender the goods to the seller on surrender of the accepted draft or repayment of the amount thereof. Centola v. Italian Discount & Trust Co., 135 Misc. 697, 238 N. Y. Supp. 245 (N. Y. City Cts. 1929).

163. *In re* Canal Bank & Trust Co.'s Liquidation, 178 La. 575, 152 So. 297 (1933).

164. Ordinarily, whether the payment is made for the honor of the drawer or the acceptor, the payer is ". . . subrogated for, and succeeds to . . ." the right of the holder against the acceptor. NEGOTIABLE INSTRUMENTS LAW § 175.

165. The like objection would be fatal to any cross-claim of the defendant against the plaintiff on grounds of quasi-contract.

166. Bank of Anderson v. Allen, 146 S. C. 167, 143 S. E. 646 (1928), 60 A. L. R. 584 (1929) (bank in liquidation); 3 WILLISTON, CONTRACTS § 1998 (bankruptcy); FEDERAL BANKRUPTCY ACT, 30 STAT. 565 (1898), 11 U. S. C. A. § 108 (b) (2) (1927).

given is the principal the other will be discharged on familiar principles of suretyship,[167] unless the creditor believed that the one to whom he gave time was the surety.[168]

(5) Lastly, the suretyship relation suggests the possible pertinency of principles forbidding indirect attack. That matter is treated under the next topic.

VII. Nonfulfillment of Conditions or Other Requirements of a Letter of Credit in Respect to Shipping Documents and Similar Matters

A. Form and Transmission of Shipping Documents

Frequently a letter of credit contains not only a promise to pay, or to accept and pay, drafts representing the purchase price of the goods, but also a requirement concerning certain shipping, storage, insurance, or other documents. The promise is then generally interpreted as conditioned on the presentation and surrender of the specified documents in proper form.[169] This is particularly true in the familiar C. I. F. transaction, in which the seller agrees to ship the goods, pay the freight thereon either in advance or through a credit note transmitted to the buyer, and take out and pay for insurance; all for an aggregate price which is large enough to cover not only the intended cost of the goods to the buyer at the place of shipment but also the freight and insurance premium.[170] In such a transaction the person issuing a letter of credit, whether he be the buyer of the goods or, as is more frequently the case, a bank or other person acting in the buyer's behalf, is not excused from performing his promise by the fact that, the goods having not yet arrived at destination, there is no previous opportunity for inspection.[171] This is an additional fact which makes all the more strongly for interpreting the promise of the letter as conditional. In such a transaction the documents usually required are bill of lading, commercial invoice, consular invoice, and a policy or certificate of insurance.[172]

Other documents are sometimes required. In *Moss v. Old Colony Trust Co.*[173] the promise was held to be conditioned on the presentment of a re-

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167. Michigan State Bank v. Estate of Leavenworth, 28 Vt. 209 (1856) (letter of credit running to *H* and signed by *P* and by *S*, his known surety; drafts drawn by *H* on *P*; extension of time given by *H* to *P*; held, *S* discharged).

168. Bailey v. Edwards, 4 B. & S. 761 (Q. B. 1864) (holding that a creditor who is in doubt as to the relation extends time at his peril).

169. New York & Va. State Stock Bank v. Gibson, 5 Duer 574 (N. Y. 1856); Germania Nat. Bank v. Taaks, 101 N. Y. 442, 5 N. E. 76 (1886) (promise to pay sight drafts ". . . which you advise us as having been drawn against particularly described shipments . . ."); see Bank of Montreal v. Recknagel, 109 N. Y. 482, 491, 17 N. E. 217, 220 (1888).

170. 1 Williston, Sales §§ 280c-280f.

171. *Id.* § 280c, nn. 56, 57.

172. The requirement of a policy of insurance is not generally satisfied by a certificate that the policy has been issued. *Id.* § 280e, at 612-616.

173. 246 Mass. 139, 140 N. E. 803 (1923).

quired inspection certificate of the United States Chamber of Commerce in Buenos Aires certifying sugar to be of a certain quality, as well as on the fulfillment of a requirement that an Argentine Export License should be shown by the bill of lading.

Whether the sale is a C. I. F. transaction, a C. and F. transaction, or of some other nature, in order that he may meet the conditions of the promise, the seller of the goods or the purchaser of the draft, as the case may be, must present and surrender required documents [174] which individually or collectively[175] import the shipment of goods of the kind, quantity, and quality specified by the letter of credit; [176] and also that the goods were shipped within the specified time,[177] at the specified place,[178] to the specified

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174. Thus the requirement of shipping documents in the form of dock receipt or bill of lading was held not to be satisfied by the tender of an unaccepted delivery order by the seller on an importer, though the importer had received payment for and would have delivered the goods. Arctic Ice & Coal Co. v. Southgate, 287 Fed. 48 (C. C. A. 4th, 1923).

175. De Sousa v. Crocker First Nat. Bank, 23 F. (2d) 118 (N. D. Cal. 1927); see Camp v. Corn Exchange Nat. Bank, 285 Pa. 337, 347, 132 Atl. 189, 192 (1926).

176. International Banking Corp. v. Irving Nat. Bank, 283 Fed. 103 (C. C. A. 2d, 1922), *aff'g*, 274 Fed. 122 (S. D. N. Y. 1921) (silk to be made as per buyer's designs, and total width of stripes not to exceed 50 per cent of width of silk); Banco Nacional Ultramarino v. First Nat. Bank, 289 Fed. 169 (D. Mass. 1923) (action by purchaser of draft against issuing bank; "C. and F." sale of "white crystal sugar"; required documents showed "crystal" sugar; an unrequired public certificate of inspection showed "white crystal"; held insufficient); Crocker First Nat. Bank v. De Sousa, 27 F. (2d) 462 (C. C. A. 9th, 1928) (action by seller against issuing bank; C. I. F. sale of 150 tons of "white Java refined granulated sugar" and 350 tons of "white Java refined fine granulated sugar"; required documents including consular invoices and surveyor's certificates of quality, omitted the word "refined" as to the first lot, and "refined" and "granulated" as to the second lot; held insufficient as to both lots); Manatee County State Bank v. Weatherly, 144 Ala. 655, 39 So. 988 (1905) (defendant guaranteed that buyer would pay draft provided that bill of lading should be accompanied by certificate that oranges were ". . . sound and shipped according to signed contract . . ." of sale; judgment for defendant on ground that certificate stated only that they were "sound"; strict construction theory relied on); Brown, Graves & Co. v. Ambler, 66 Md. 391, 7 Atl. 903 (1887); Bank of Italy v. Merchants Nat. Bank, 236 N. Y. 106, 140 N. E. 211 (1923) (telegram of credit required "dried grapes"; bill of lading stated "raisins"; held not sufficient because, while raisins are dried grapes, there was considerable evidence to the effect that by mercantile usage the two terms referred to distinct products); National City Bank v. Seattle Nat. Bank, 121 Wash. 476, 209 Pac. 705 (1922) (action by purchaser of draft against correspondent of issuing bank); see Note (1924) 30 A. L. R. 353.

In Lamborn v. Lake Shore Banking & Trust Co., 196 App. Div. 504, 188 N. Y. Supp. 162 (1st Dep't, 1921), *aff'd*, 231 N. Y. 616, 132 N. E. 911 (1921), in an action brought by the seller, judgment was rendered for the issuing bank on the ground that the letter called for Java white granulated sugar and the bill of lading omitted the word "granulated". It did not appear whether the other required documents contained the word.

In Portuguese American Bank v. Atlantic Nat. Bank, 200 App. Div. 575, 193 N. Y. Supp. 423 (1st Dep't, 1922), in an action brought by the purchaser of a draft against a bank guaranteeing payment of a draft covering eggs of specified quality to be shipped by express, neither express receipt nor invoice covering eggs of that quality, judgment was given for the guaranteeing bank. The court said that an invoice, even in proper form, would not have sufficed, since it would be only the seller's declaration. It is submitted that it would have to suffice, because the express receipt, the only other required document, would at the most state that the eggs were "said" to be of the specified quality.

But see the doubtful decision in Decatur Bank v. St. Louis Bank, 21 Wall. 294 (U. S. 1874) (holding that hogs satisfied the requirement of "cattle" because the latter term in its broader sense included domestic quadrupeds generally).

177. See Banco Nacional Ultramarino v. First Nat. Bank, 289 Fed. 169, 176 (D. Mass. 1923) (denial of right in seller). Compare Norrington v. Wright, 115 U. S. 188 (1885) (action by seller against buyer for breach of contract), with Camp v. Corn Exchange Nat. Bank, 285 Pa. 337, 346, 132 Atl. 189, 192 (1926) (litigation between banker and buyer of goods).

destination,[179] via the indicated route, and by the designated carrier, vessel, or mode of transportation. Moreover, the documents must be in proper form [180] and, indeed, in the particularly designated form, if any,[181] and be transmitted in the designated manner; [182] and the insurance policy or certificate must cover the property stated to be shipped by the other documents.[183] Furthermore, the letter may require, and the promise thus be

The word "immediately" does not mean instantly, but as soon as possible under the circumstances known to the parties. Second Nat. Bank v. Lash Corp., 299 Fed. 371 (C. C. A. 3d, 1924).

Of course, if the issuing bank pays the purchaser of the draft, knowing that the bill of lading imports shipment later than the specified time, there being no mistake, the former has no quasi-contractual cause of action against the latter, to which the buyer who reimburses the issuing bank can be subrogated. Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp., 216 App. Div. 495, 215 N. Y. Supp. 525 (1st Dep't, 1926), *aff'd,* 245 N. Y. 377, 157 N. E. 272 (1927).

Goods may be shipped too soon as well as too late. Thus, in United States Steel Products Co. v. Irving Bank-Columbia Trust Co., 9 F. (2d) 230 (C. C. A. 2d, 1925), a revocable letter of credit was modified by the issuing bank (acting under instructions from the buyer) to the effect that the goods were not to be shipped before a certain time; it was held that documents showing shipment before that time were not a compliance with the condition of the modified letter. Accord: Foerderer v. Moors, 91 Fed. 476 (C. C. A. 3d, 1898) ("to be shipped"; goods shipped before letter issued and bill of lading so disclosed; held, guarantor of undertaking of buyer not liable to issuing bankers).

178. *Cf.* Filley v. Pope, 115 U. S. 213 (1885) (action by seller against buyer for breach of contract).

179. Thus, in Lamborn v. Nat. Bank of Commerce, 276 U. S. 469 (1928), the court conceded that in a C. I. F. transaction a letter of credit requiring shipment of sugar "by steamer from Java to Philadelphia" could be satisfied only by a bill of lading to that effect, since the beneficial ownership of the goods would pass at the place of shipment, but held that, the instant case being one of sale "f. o. b. cars Philadelphia", the condition, properly interpreted, did not require that the steamer should have been continuously so destined, but that it sufficed that the destination was changed *en route* without loss of time from "Port Said, option New York" to "Philadelphia" (four justices dissenting). The court also held that a requirement of the letter of credit that the seller should furnish a copy of an "ocean bill of lading covering shipment Java to Philadelphia" had in fact been waived by the issuing bank (four justices dissenting). This case reversed National Bank of Commerce v. Lamborn, 2 F. (2d) 23 (C. C. A. 4th, 1924). Other cases involving similar litigation are Matthew Smith Co. v. Lamborn, 276 Fed. 325 (S. D. N. Y. 1921), *aff'd,* 10 F. (2d) 697 (C. C. A. 2d, 1926), and cases cited therein, and in Lamborn v. National Bank of Commerce, 276 U. S. 469, 474, n. 2 (1928).

180. Thus, in Pioneer Bank v. Canadian Bank of Commerce, 53 Can. Sup. Ct. 570 (1916), Note (1921) 13 A. L. R. 166, it was held that the simple requirement of "bill of lading attached" could be fulfilled only by a bill of lading in such form as eventually to insure to the issuing bank exclusive control over the goods. Of course, as in First Nat. Bank v. Bowers, 141 Cal. 253, 74 Pac. 856 (1903), circumstances may be such as to lead to the opposite interpretation, or at least prevent the court from directing a verdict for the issuing bank.

181. Accordingly, a bill of lading running to the order of the seller and indorsed in blank by him does not fulfill a requirement that it be to the order of the banker issuing the letter. The possibility of the levy of an attachment or execution on the goods as property of the seller, and the variation in the statute and common law of the states in respect to the validity thereof and the protection of a subsequent bona fide taker of the negotiable document of title, as well as the procedural risk which would rest on the latter, show that the difference is a real one. Lamborn v. Lake Shore Banking & Trust Co., 196 App. Div. 504, 188 N. Y. Supp. 162 (1st Dep't, 1921). But *cf.* Bank of America v. Whitney-Central Nat. Bank, 291 Fed. 929 (C. C. A. 5th, 1923), *cert. denied,* 264 U. S. 598 (1924).

182. Murdock v. Mills, 11 Metc. 5 (Mass. 1846) (bill of lading and insurance order transmitted separately by mail, instead of "accompanying" draft).

183. In Pan-American Bank & Trust Co. v. National City Bank, 6 F. (2d) 762 (C. C. A. 2d, 1925), the bill of lading read: "Loaded . . . on board of the steamer Tocantins . . . or in another steamer belonging to . . ." the named steamship company; the policy insured goods in the Tocantins. It was held, first, that the law of Brazil, the place of shipment, including the effect of usage on or under that law, governed the sufficiency of the bill of lading; and, secondly (L. Hand, J., dissenting), that the accompanying policy corresponded

conditioned on, the transmission of certain papers; for example, duplicates of one or more of the shipping documents, directly to the drawee,[184] or to a person other than the drawee.[185]

In this connection, however, it is well to remember that the issuing bank, as might a buyer of goods, may be estopped from asserting nonfulfillment of a condition because it assigned another ground of objection and so led the seller, or purchaser of the draft, as the case may be, to refrain from taking remedial steps which otherwise he could and would have seasonably taken.[186] At times courts have tended to overlook this requirement of prejudice, or have too readily found it to be satisfied.[187]

It now becomes pertinent to inquire how far the purchase price as disclosed by the invoice must correspond with the amount of the draft. Obviously, if the purchase price so disclosed is less than the amount of the draft, the latter is excessive and the condition of the promise is not fulfilled.[188] But a purchase price greater than the amount of the draft presents a different case. In *Wells Fargo Nevada Nat. Bank v. Corn Exchange Nat. Bank* [189] the draft was drawn in less amount than the purchase price shown by the invoice to avoid exceeding the limit of the letter of credit, and the invoice stated that the residue was represented by a draft drawn directly on the buyer of the goods; in an action brought by a purchaser of the former draft against the issuing bank, it was held that the invoice did not conform to the requirements of the letter in that it disclosed that the issuing banker would be acquiring only part of the ownership of the documents of title and the goods, the buyer acquiring the remaining part. In a C. I. F. transaction, as this was, aside from any question of defect in the documents, entire beneficial ownership passes to the buyer at the time of shipment, the seller retaining legal title only by way of security for the price,[190] and the banker later acquiring legal title only as security for his advance. Thus the invoice seems to have been in keeping with the promise of the issuing banker and indeed purported to give something which he had not required; that is, a

with the bill of lading, since the bill, as explained by the policy, imported that the goods were loaded on the Tocantins.

Finkelstein, in his able treatise, *op. cit. supra* note 139, at 182 *et seq.*, points out that similar rules govern the sufficiency of shipping documents tendered by seller to buyer.

184. Question not answered in Lamborn v. Lake Shore Banking & Trust Co., 231 N. Y. 616, 617, 132 N. E. 911 (1921).

185. Banco Nacional Ultramarino v. First Nat. Bank, 289 Fed. 169 (D. Mass. 1923).

186. Lamborn v. Cleveland Trust Co., 29 F. (2d) 46 (C. C. A. 6th, 1928); Cleveland Trust Co. v. Lamborn, 44 F. (2d) 300 (C. C. A. 6th, 1930); *cf.* Moss v. Old Colony Trust Co., 246 Mass. 139, 150, 140 N. E. 803, 807 (1923); 2 WILLISTON, SALES §§ 494a, 494b, 495.

187. Railway Co. v. McCarthy, 96 U. S. 258 (1877); 2 WILLISTON, SALES § 494a, nn. 92, 93; *cf.* Second Nat. Bank v. Lash Corp., 299 Fed. 371 (C. C. A. 3d, 1924); Bank of Taiwan v. Union Nat. Bank, 1 F. (2d) 65 (C. C. A. 3d, 1924).

188. Also, in Lamborn v. Lake Shore Banking & Trust Co., 196 App. Div. 504, 188 N. Y. Supp. 162 (1st Dep't, 1921), a draft for the amount of the letter of credit "with exchange" was held to be excessive and the issuing bank relieved of liability.

189. 23 F. (2d) 1 (C. C. A. 7th, 1927).

190. 1 WILLISTON, SALES § 280c, n. 62; 2 *id.* § 435.

margin of security. Furthermore, even though the transaction of sale is such that title would not pass from the seller until payment is received, still it is submitted that entire beneficial ownership would then pass to the buyer, the legal title of the bank being merely for the purpose of security.

B. Forgery of Shipping Documents or Absence of Described Goods

While it is clear that the promise of the person issuing the letter of credit is conditioned on the delivery of specified documents in proper form, it is frequently difficult in a particular case to determine whether the promise is also conditioned on their genuineness and their truthfulness as to the presence of goods. This is a question of objective interpretation in the light of the circumstances.[191] Several factors are involved. In the first place, it is to be observed that the buyer and the banker who finances him do not trust entirely to the seller: they do not pay cash or transmit to him negotiable paper, for example, an accepted bill, in advance of the shipment; on the other hand, their evident purpose is to give to the seller and his financing banker certain assurances which are effective before the goods are delivered by the carrier to the buyer at destination; [192] thus, if the letter is irrevocable,[193] the seller is assured that if he buys or manufactures the described goods he will have a market for them, and, if the letter is irrevocable, or, being revocable, is unrevoked, that when he ships them, and procures and transmits the proper shipping documents, he will not only be assured of payment of the purchase price but of having a market for the draft representing the price.[194] If the promise in the letter is conditioned only on the form of the shipping documents, and not on their genuineness and truthfulness as to the presence of goods, the seller's drafts will be the more easily negotiated and the seller thus be encouraged to enter the transaction—encouragement usually needed because of the distance between the parties and their nonacquaintance. On the other hand, to hold that the

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191. Of course, the language of the letter may be so clear that this question must be answered in the negative. Such was the fact in Bank of Taiwan v. Gorgas-Pierie Mfg. Co., 273 Fed. 660 (C. C. A. 3d, 1921), where the draft was to be accompanied by a bill of lading "to be dated within September or October, 1920". It seems clear that the purchaser of the draft in due course could enforce payment from the issuing bank, although the goods were not shipped until November 4, 1920. The court properly denied to the issuing bank the right to interplead the purchaser of the draft and the buyer of the goods on the ground that the question of whether the purchaser of the draft was a holder in due course and so entitled to payment from the issuing bank was one to be litigated in a proceeding to which both were parties. *Cf.* Bank of Taiwan v. Union Nat. Bank, 1 F. (2d) 65 (C. C. A. 3d, 1924).

192. The beneficial interest in the goods generally passes to the buyer at the time of delivery to the carrier; even in a C. I. F. transaction, while the seller is to pay the freight, the prima facie presumption resulting therefrom is rebutted by the fact that the seller is to insure the goods on behalf of the buyer and financing banker, whereby the risk of loss and hence the beneficial interest in the goods are indicated to be in the buyer during carriage. 1 WILLISTON, SALES § 280c.

193. It is usually so accounted if the contrary is not stated and if supported by consideration, for example, the payment or promise of a commission made by the buyer to the issuing bank. 2 *id.* § 469e.

194. See 85 U. OF PA. L. REV. at 193.

promise is conditioned on the genuineness of the shipping documents and on the presence of goods is to give to the buyer the assurance that he will not have to pay for goods which he may never receive, and to bring to the financing banker the confidence that he will not have to make advances on nonexisting security. Under modern conceptions of the sale of goods, the early doctrine of caveat emptor has been much criticized and limited. Hence, it would seem that, for the encouragement of the parties who the more need encouragement (that is, the buyer of the goods and the banker who finances his purchase), the interpretation more favorable to them should be usually taken, the consequence being that forgery [195] or alteration of the bill of lading, or the absence of the described goods,[196] or the shipper's lack of title thereto, should defeat recovery, whether the action is brought against the issuing banker by the seller of the goods or by a bona fide purchaser of the draft.[197] Nor should it matter whether it was the seller who perpetrated or participated in wrongful conduct, or someone from whom he innocently acquired the document. In this connection it should be remembered that certain other requirements of a letter of credit have been interpreted as conditions of the promise, although it would be impossible for a purchaser of the draft to ascertain whether they have been or will be fulfilled by a mere inspection of the accompanying shipping documents.[198]

195. For conflicting views entertained by Professor Karl N. Llewellyn (favoring the issuing bank) and Dr. Finkelstein (favoring the purchaser of the draft), see the latter's treatise, *op. cit. supra* note 139, at 239-243.

Of course, if the issuing bank accepts or pays the draft, certain principles of negotiable instruments and quasi-contracts enter in, which protect the purchaser of the draft. Springs v. Hanover Nat. Bank, 209 N. Y. 224, 103 N. E. 156 (1913); CAMPBELL, CASES ON BILLS AND NOTES (1928) 925-930; WOODWARD, QUASI-CONTRACTS (1913) § 91; Ames, *The Doctrine of Price v. Neal* (1891) 4 HARV. L. REV. 297, 303.

196. Old Colony Trust Co. v. Lawyers Title & Trust Co., 297 Fed. 152 (C. C. A. 2d, 1924), *cert. denied*, 265 U. S. 585 (1924). Letter of credit available by sight drafts against shipments of sugar, "net landed weights"; negotiable delivery order or warehouse receipt required. When one draft and warehouse receipt were tendered, only part of sugar was in warehouse; when second draft and delivery order were tendered, sugar had not been landed and weighed; held for defendants as to both drafts.

Of course, since in a C. I. F. transaction the buyer becomes the beneficial owner of proper goods at the time of delivery to the carrier, any *subsequent* loss or deterioration is at the risk of the buyer and hence affords no defence to the promise contained in the letter of credit. 1 WILLISTON, SALES § 280c, n. 63.

The fact that under certain circumstances the holder of the document of title has a remedy against the carrier or warehouseman (2 *id.* §§ 418-420a) is immaterial; the purchaser of the draft would better be remitted to that remedy than the issuing bank.

Variation in the kind of goods, as distinguished from quality, for example, rags instead of silk, might conceivably be placed on the same footing as absence of goods.

197. Of course, the circumstances attending the transaction may be such as to lead to an unrestrictive interpretation of the letter. Thus, where the bearer of the letter, for example, a buyer or consignor, is known to the issuing banker (and especially, if he be a customer) and is a stranger to the purchaser of the draft and known by the issuing banker to be such, it may well be inferred that the promise of the banker is not conditioned on the genuineness of the required shipping documents. Young & Son v. Lehman, Dun & Co., 63 Ala. 519 (1878) (case could have been rested on another ground).

198. For example, a requirement that certain papers, such as duplicates of shipping or other documents, be forwarded directly to the drawee or another person: see Banco Nacional Ultramarino v. First Nat. Bank, 289 Fed. 169, 176 (D. Mass. 1923); and a requirement that a vessel sail within a specified time: Commercial Union of America v. Anglo-South American Bank, 16 F. (2d) 979 (C. C. A. 2d, 1927).

C. Variations of Quality, Quantity or Price

When the case is one involving merely defect in the quality of the goods, it seems that the promise of the letter is not generally to be interpreted as conditioned on the goods being of the quality stated therein. The right of the banker purchasing the drafts and the obligation of the banker issuing the letter would not ordinarily be intended to depend on a question which is inherently difficult (and indeed impossible of solution while the goods are in transit), and more appropriate for persons engaged in trade than in finance. Hence, notwithstanding that the goods are in fact of inferior quality, a holder in due course of the draft may have judgment against the person issuing the letter of credit, whether the latter be the buyer or a financing banker.[199] Indeed, any person (other than the seller) who is a promisee of a letter of credit and acts on the promise in good faith and without knowledge or notice of defect in the quality of the goods, may have judgment against the person issuing the letter.[200] If, however, the purchaser of the draft has knowledge, suspicion or notice of the defect in the goods, or any other breach of the contract of sale, for which the buyer may properly reject the goods or rescind the sale, he is in no better case than the seller and hence, in the writer's opinion, should be generally denied recovery on the letter of credit because usually the promise therein runs to bona fide holders of drafts, and at any rate because he knows that the seller has drawn against the letter without justification.[201]

One's thoughts now naturally turn to the case of an action brought by the seller. In the first place, it is clear that the issuing banker is not excused from making payment of the draft pending an inspection or other investigation into the quality of the goods, any more than a buyer is so entitled under a C. I. F. contract.[202] If he declines to make payment for that reason and the goods are of proper quality, he is in default. But let it be assumed that, while specified documents of proper form are tendered, the goods are in fact of such defective quality that the buyer justifiably rejects them or rescinds the sale. Different views may be taken:

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199. Bank of Plant City v. Canal-Commercial Trust & Savings Bank, 270 Fed. 477 (C. C. A. 5th, 1921); Continental Nat. Bank v. National City Bank, 69 F. (2d) 312 (C. C. A. 9th, 1934) (excellent opinion by Mack, J.: "Cement to be of a sound merchantable quality and standard of same shall meet with the requirements of the American Society for Testing Materials").

All the more is this interpretation indicated if the goods are known to be in transit at the time the letter of credit or the guaranty is issued. See Bank of Plant City v. Canal-Commercial Trust & Savings Bank, 270 Fed. 477, 481 (C. C. A. 5th, 1921).

200. Thus, in Second Nat. Bank v. Columbia Trust Co., 288 Fed. 17 (C. C. A. 3d, 1923), the defendant bank, at the request of the buyer of sugar, arranged a credit for the seller with the plaintiff trust company and undertook to pay the plaintiff a certain sum on delivery of specified shipping documents; in reliance on this undertaking and similar undertakings by other banks, the plaintiff issued a letter of credit in much larger amount to the seller which enabled him to make purchases abroad; it was held that the plaintiff was entitled to judgment notwithstanding breach of the seller's contract with the buyer.

201. See Bank of Taiwan v. Union Nat. Bank, 1 F. (2d) 65, 66 (C. C. A. 3d, 1924).

202. 1 WILLISTON, SALES § 280c, nn. 56, 57.

(1) That the issuing bank is liable to the seller even though the letter of credit requires shipping documents covering goods of a certain quality and the goods are not of that quality,[203] the reason frequently advanced being that the bank is "purchasing the documents" and not the goods. While this view is sustained by most authorities, the writer seriously doubts its soundness. It must be observed that it results in driving the issuing bank to exact reimbursement from the buyer and the latter, in turn, to an action for breach of contract against the seller, who is quite often resident in a foreign country and who may be insolvent or about to become so.

(2) That the issuing bank is liable to the seller if the requirement of quality is contained only in the contract of purchase, but not liable if it is stated in the letter of credit. This is the view expressed by Judge Cardozo in his dissenting opinion in *Maurice O'Meara Co. v. National Park Bank*.[204] It is rested on the theory of a representation of the truthfulness of the required documents [205] made by the seller when he presents the draft to the issuing bank. This theory of representation seems to be sound as far as it goes. It is equally applicable whether the seller acts fraudulently or innocently. While it must be conceded that neither the goods nor the documents are being sold to the banker, nevertheless the receipt of the purchase price on the part of the seller has the double effect of simultaneously vesting beneficial ownership in the buyer and legal title in the banker by way of security. Consequently, there is just as much reason to find a representation of the truthfulness of the documents here as if payment were being requested directly from the buyer.[206] Here again a sharp distinction is to be taken between the seller and a bona fide purchaser of the draft. Clearly, the latter is in no position to make a representation concerning the truthful-

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203. Imbrie v. D. Nagase & Co., 196 App. Div. 380, 187 N. Y. Supp. 692 (2d Dep't, 1921) (held that issuing bank was bound to pay the seller, notwithstanding defects of quality and weight, and hence could not recover payment from the seller on discovery thereof); Maurice O'Meara Co. v. National Park Bank, 239 N. Y. 386, 146 N. E. 636 (1925); see Second Nat. Bank v. Columbia Trust Co., 288 Fed. 17, 20 (C. C. A. 3d, 1923) (distinguishing letter of credit from guaranty); De Sousa v. Crocker First Nat. Bank, 23 F. (2d) 118, 123 (N. D. Cal. 1927); Crocker First Nat. Bank v. De Sousa, 27 F. (2d) 462, 464 (C. C. A. 9th, 1928); First Wisconsin Nat. Bank v. Forsyth Leather Co., 189 Wis. 9, 17, 206 N. W. 843, 846 (1926); Note (1925) 39 A. L. R. 755.

In Bank of East Asia v. Pang, 140 Wash. 603, 249 Pac. 1060 (1926), a Chinese bank had issued an export letter of credit and its agent in the United States had paid the draft drawn on it by the seller; though the goods later turned out to be inferior, the issuing bank was denied restitution from the seller on the ground that the bank was bound to the seller irrespective of such inferiority. Here the decision was necessarily rested on this ground. Had restitution been sought from a bona fide purchaser for value of the draft, however, it could have been denied independently of the bank's liability on the letter. Springs v. Hanover Nat. Bank, 209 N. Y. 224, 103 N. E. 156 (1913); CAMPBELL, *loc. cit. supra* note 195, at 925-930; BRANNAN, NEGOTIABLE INSTRUMENTS LAW (5th ed. by Beutel, 1932) 712-715.

The view stated in paragraph (1) of the text is ably supported by Finkelstein, *op. cit. supra* note 139, at 224-236.

204. 239 N. Y. 386, 401, 146 N. E. 636, 641 (1925).

205. 2 WILLISTON, SALES § 632.

206. No claim can be made that beneficial ownership accrued to the buyer on shipment, since the seller by shipping goods of inferior quality did not comply with the contract. 1 *id.* § 278, nn. 88-90.

ness of the documents, and does not do so, any more than of their genuineness.[207]

(3) That the issuing bank may defend the action brought by the seller on the ground of inferiority of quality, whether the requirement was contained in the contract of purchase, or in the letter of credit, or both. The writer believes this view has much to commend it. If, as between banker and buyer, it is the duty of the latter to put the former in funds, the banker is in the position of surety for the buyer and, the latter having denied or rescinded his obligation to perform because of the inferiority of the goods, a defence should then be given to the banker on ordinary principles of suretyship for the protection of the buyer against indirect attack. The fact that the banker's promise to the seller is to pay the draft, or accept and pay it, and is thus primary in form, is immaterial. The relation of surety and principal exists here as much as if the banker's promise were a guaranty (that is, conditioned on nonperformance by the buyer) and should be equally determinative.[208] Furthermore, the buyer should be able to enjoin the seller from bringing an action against the banker.[209] Thus, the buyer would have double protection against indirect attack. It may be argued that, in view of this suggested injunctive remedy avaliable to buyer against seller, no defence need be reposed in the issuing banker. Nevertheless here, as in other cases of suretyship,[210] the additional protection seems to be justified because it is easier and simpler.[211] One difference should be observed between this and ordinary cases of suretyship: there, a defence being given to the surety, he must use it, else he cannot have reimbursement from the principal for lack of causation; here, the question of inferiority of the goods is one of such inherent uncertainty that the banker should not be under the burden of resisting the seller's action at his peril, but, as far as the buyer is concerned, should have an election either to defend, if led to do so by a regard for his own[212] or the buyer's interests, or to disregard the defence, pay the seller, and have recourse against the buyer.[213] In other words, the

207. 2 *id.* § 435; Leather v. Simpson, L. R. 11 Eq. 398 (1871).

208. See *supra* sub-topic VI; also the writer's article, *Protection Against Indirect Attack* in HARVARD LEGAL ESSAYS (1934) 3, 7.

209. But see Frey & Son v. E. R. Sherburne Co., 193 App. Div. 849, 184 N. Y. Supp. 661 (1st Dep't, 1920) (denying injunction against seller and issuing banker, though buyer, under terms of contract, had cancelled same in toto because of failure of a vessel to clear promptly from Java).

210. Campbell, *loc. cit. supra* note 208.

211. The banker's defence could also be rested on the ground of circuity of action: if the seller be allowed to recover the amount of the draft from the banker, the latter will have redress in like amount against the buyer either by action or by charging his account, and the buyer in turn will have full recovery from the seller for breach of contract (provided, of course, as is usually true, that title to the goods remained in the seller because of the inferiority of quality).

212. In case the buyer is insolvent or in danger of insolvency and there is no sufficient additional security, as was so often the case after the violent decline in the price of sugar in 1920, his own interest will prompt him to make the defence.

213. *Cf.* First Wisconsin Nat. Bank v. Forsyth Leather Co., 189 Wis. 9, 206 N. W. 843 (1926).

liability of buyer to banker should not here be dependent on the banker's being bound to the seller, or even on reasonable belief that he is so bound.

There remain for consideration two situations in which the relation is reversed and the banker and the buyer stand as principal and surety respectively. In the first, the buyer puts the banker in funds, not generally, but for the purpose of paying the draft,[214] either when the letter is issued or subsequently; if when the letter is issued, the relation between banker and buyer has always been that of principal and surety, since as between them it has been the duty of the banker to use the funds in payment of the draft in ease of the buyer; if subsequently, as the buyer frequently does in fulfillment of his undertaking, it becomes the duty of the banker thus to utilize the funds and his position is forthwith changed from surety to principal. The second situation [215] is that in which it is understood at the time of issue that the payment to be made by the banker shall be an advance to the buyer secured by the documents of title (and sometimes by other security) and later to be repaid by the buyer at a fixed time or on resale of the goods, with interest or commission or both. Here also, because of the bilateral contract between them, the banker owes to the buyer the duty of paying the draft, so that the relation is that of principal and surety, respectively.[216] Nevertheless, in both situations, the risk of the buyer seems to justify the application of the doctrine of protection against indirect attack.[217] In the first situation, his risk pertains to the funds in the banker's hands: if the banker is allowed to defend and does defend against the non-performing seller, the funds will be repaid to the buyer; otherwise, to the seller. In the second situation the buyer's risk consists in his ultimate liability to repay the advance. Thus, in both cases a defence should be reposed in the banker, even though he be a principal, for the protection of a buyer who has justifiably rejected the goods or rescinded the sale for inferiority of quality.

Whether the banker is surety for the buyer or vice versa, the doctrine of protection against indirect attack might be better squared with commercial interests and be the more readily received by the courts if it were so qualified as to require that the buyer authorize the banker to defend the seller's action or, with the banker's consent, himself take over or participate in the defence. Compliance with this requirement would in effect make the

Hence, it is clear that the buyer cannot enjoin the *issuing bank* from paying the seller. Williams Ice Cream Co. v. Chase Nat. Bank, 210 App. Div. 179, 205 N. Y. Supp. 446 (1st Dep't, 1924), *rev'g*, 120 Misc. 301, 199 N. Y. Supp. 314 (Sup. Ct. 1923).

214. Of course, no trust of specific money is ordinarily intended or created.

215. This situation is not infrequent, especially when the draft is a sight draft as distinguished from one payable at a fixed time after date or sight.

216. If the defect in quality was so essential as to justify the banker in rescinding his contract with the buyer and thus imposing on the latter the duty of putting the former in funds to meet the draft, the banker would become surety for the buyer.

217. Also, the defence of circuity of action might be available here. See *supra* note 211.

buyer a party to the action and hence would have advantages for the seller which probably would not otherwise be present: admissions made by the buyer could be introduced in evidence by the seller; and a judgment in favor of the seller here would conclude the buyer in any subsequent litigation between them in respect to pertinent matters of law or fact so adjudicated.

Defects of quality suggest the possibility of variations in quantity and of price or value; that is, situations where the required quantity of goods is stated by the shipping documents, and more particularly by the bill of lading, but such quantity is not in fact present, or where the price or value is overstated by the documents, for example, by the invoice. Quantity, price and value would seem to be no more matters of condition than is quality, and the principles applicable to the latter would seem to govern the former. Thus, despite such variation, the banker issuing the letter is liable to the bona fide purchaser of the draft; [218] whether he is liable to the seller depends on which of the above-stated views concerning defect of quality is to be taken.[219]

Furthermore, even when the action against the issuing bank is brought by one who took the draft in due course, the facts may be such as to reduce recovery below the amount of the draft. Thus, when a consignor of goods for sale obtains a loan on the draft for less than its amount, and there is a defect in quality, quantity, price or value as represented by the shipping documents, the bona fide secured lender can recover no more than the amount of his loan; for any surplus would be held by him in trust for the consignor, and the latter should not have recovery from the consignee, or a banker issuing a letter of credit in his behalf, through the security device any more than he could in a direct action.[220] Likewise, when the drawer of the draft is a seller rather than a consignor of goods, the bona fide lender should recover only the amount of the loan from the banker; for any excess would be recovered for the account of the seller and, on principles forbidding indirect attack on the buyer and circuity of action, the seller should be denied recovery from the banker not only immediately but also through the intervention of a security transaction.

One now naturally turns to the question whether other matters which would be a defence to the buyer in an action brought against him by the seller will avail the issuing bank. In *Grouf v. State Nat. Bank* [221] the ques-

218. See Vallé v. Cerré's Adm'r, 36 Mo. 575, 591 (1865) (consignor of goods, authorized to draw for three-fourths of value, drew for three-fourths of value, as represented by a bill of lading overstating weight, and invoice overstating unit value; held, issuing bank bound to bona fide purchaser of draft).

219. Imbrie v. D. Nagase & Co., 196 App. Div. 380, 187 N. Y. Supp. 692 (2d Dep't, 1921) (defects in weight and quality; held, issuing bank bound to seller). And see Urquhart Lindsay & Co. v. Eastern Bank, [1922] 1 K. B. 318 (banker held not justified in refusing to pay amount of invoice, though assumed to be in excess of contract price).

220. Vallé v. Cerré's Adm'r, 36 Mo. 575 (1865) (recognized that recovery would be so limited).

221. 40 F. (2d) 2, 6 (C. C. A. 8th, 1930).

tion was left unanswered whether payment made by the bearer of the letter to the holder of the draft would be a defence to an action brought by the latter against the issuing bank.[222] The writer would answer the question in the affirmative, especially if the banker be in the relation of a surety to the bearer of the letter.[223] One may also suppose a case of impossibility which excuses the buyer from performing his contractual obligation to the seller; the question is whether it would likewise afford an excuse to the issuing banker. Obviously it will not as against a purchaser of the draft in due course. As against the seller himself the question is quite similar to that raised by defect in quality, quantity or price. In view of the weight of authority on that question, one would expect most courts to answer this in the negative,[224] although the opposite result would seem to be preferable.

D. Conditions Independent of Shipping Documents

It is also to be observed that the requirements of a letter of credit may be interpreted as constituting conditions even though they pertain to matters which have no connection with shipping documents or with the genuineness or truthfulness thereof.[225] Thus, in *Commercial Union of America v. Anglo-South American Bank* [226] the letter of credit covered a C. I. F. sale of sugar to be shipped from New York to Spain by an unnamed steamer "sailing during first half of November, 1920"; the sugar was loaded and a proper bill of lading and other required documents presented to the defendant bank on November 13, 1920; on November 15, learning that the vessel would not sail until November 17, the issuing bank refused to pay the draft and returned the documents to the seller. In the action brought by the seller against the issuing bank, judgment for the defendant was affirmed (*per* L. Hand, J.) on the ground that, the vessel being unnamed, the letter contemplated that it should actually sail, and not merely be scheduled or expected to sail, within the first half of November, and that this requirement was a condition precedent of the defendant's promise. Also, in *First Nat. Bank v. Fiske,*[227] in an action brought by the purchaser of a draft on a letter of credit issued by a consignee of wool, it was held that the latter's promise was conditioned by a usage of the wool trade, known to the plaintiff, that drafts should not exceed three-fourths of the selling value of the wool

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222. *Grouf v. State Nat. Bank* was not a case of sale of goods, but one in which the addressee of the letter purchased a draft from the bearer of the letter.

223. See *supra* p. 261.

224. See American Steel Co. v. Irving Nat. Bank, 266 Fed. 41, 43 (C. C. A. 2d, 1920) (reasoning).

225. On the other hand, qualifying language contained in the letter has been interpreted as applying only to the agreement between the issuing banker and the buyer. See Hibernia Bank & Trust Co. v. Aron & Co., 134 Misc. 18, 21, 233 N. Y. Supp. 486, 490 (Sup. Ct. 1928).

226. 16 F. (2d) 979 (C. C. A. 2d, 1927).

227. 133 Pa. 241, 19 Atl. 554 (1890).

at the time of its arrival at destination, and, the amount of the draft being excessive, judgment was given for the defendant.

Furthermore, a requirement as to the time of negotiation of the draft or its presentation for payment [228] is usually interpreted as a condition of the promise, so that nonfulfillment of the condition will relieve the promisor from liability unless there is a legal excuse therefor.[229] If no time is specified, presentment within a reasonable time is implied.[230]

E. Recourse of Banker Against Buyer

It now becomes important to inquire into the proper interpretation of the contract between the buyer (or his surety) on the one side, and the banker issuing a letter of credit or guaranty, on the other. Usually the language is such that, interpreted in the light of the circumstances, a banker is authorized to pay the purchase price, or drafts representing the same,[231] if the specified shipping documents are delivered over,[232] and not otherwise.[233]

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228. Barde Steel Products Corp. v. Franklin Nat. Bank, 281 Fed. 814 (C. C. A. 3d, 1922); G. Jaris Co. v. Banque D'Athenes, 246 Mass. 546, 141 N. E. 576 (1923).

229. Second Nat. Bank v. M. Samuel & Sons, 12 F. (2d) 963 (C. C. A. 2d, 1926); see Note (1928) 53 A. L. R. 57.

230. Lamborn v. National Park Bank, 240 N. Y. 520, 148 N. E. 664 (1925).

231. In Richard v. Royal Bank of Canada, 23 F. (2d) 430 (C. C. A. 2d, 1928), in an action brought by the issuing bank against Richard, who was financing the buyer, it was held that payment made by the bank to the seller on the latter's receipt accompanied with surrender of required shipping documents, but without presentation of any draft, sufficed to make the defendant liable to the plaintiff; while the defendant's undertaking was to provide the plaintiff with funds on demand ". . . previous to maturity of the bills . . .", it was held merely to assume presentation of bills without making it a condition; the court points out that the seller, as drawer of a draft, would not have been liable to the defendant, so that the only function of the draft would have been that of receipt, a function fulfilled by the specific receipt.

232. Thus, in Laudisi v. American Exchange Nat. Bank, 239 N. Y. 234, 146 N. E. 347 (1924), a case arising out of a contract for the sale of Alicante Bouchez grapes, a letter written by the buyer to his bank authorized payment, or acceptance and payment, of drafts on presentation of bill of lading and commercial invoice, and the bill of lading called for grapes and the invoice for Alicante Bouchez grapes; it was held that these documents taken together sufficed, and that the bank had properly charged the account of its customer, the buyer.

233. Bank of Montreal v. Recknagel, 109 N. Y. 482, 17 N. E. 217 (1888) (buyer directed plaintiff bank to issue telegraphic letter of credit against consular invoice and bills of lading for 2,500 "bales manilla hemp"; plaintiff's London agent accepted and paid drafts after receiving bills of lading for "bales of merchandise, . . . weight and contents unknown", which bore indorsements of abstracts of invoices calling for bales of manilla hemp placed there by the seller after issue of the bills; most of the bales contained rolls of matting; judgment was affirmed for plaintiff *only* for the bales which actually were manilla hemp, on the ground that the other bills of lading were not in required form).

In Camp v. Corn Exchange Nat. Bank, 285 Pa. 337, 132 Atl. 189 (1926), it was recognized that, although discretion was explicitly placed in the bank by its contract with the buyer of the goods, it must not be abused and hence the documents must comply with the requirements of the letter; nevertheless, a bill of lading containing written notations was held sufficiently "clean", since the notations were in effect repetitions of the printed parts of the bill, which were assumed to be in customary form; also, that while the letter of credit required shipments to be completed before August 15, 1920, and the bill of lading did not so import, still other required documents, that is, the seller's declaration and the insurance contract, did so import and sufficed.

The same thing is true as between issuing bank and guarantor of the buyer's undertaking to the bank. Foerderer v. Moors, 91 Fed. 476 (C. C. A. 3d, 1898). Or issuing bank and mere

Furthermore, under the true interpretation of most contracts between buyer and issuing banker, the latter is authorized to pay the seller of goods or purchaser of the draft, provided that the specified documents are delivered over, although the goods are of a quality inferior to that specified in the contract of purchase and the buyer has informed the banker to that effect and warned him not to make payment.[234] It could not have been intended, without more appearing, that the banker should have the burden of determining at his peril the merits of a controversy between seller and buyer as to the quality of the goods.[235] For like reasons, the result should be no different if the requirement of quality is also contained in the letter of credit or guaranty. While the seller of the goods (as distinguished from a holder in due course of the draft) should not, on principle, be able to enforce recovery from the banker,[236] the very reason is that otherwise the banker *could* have recourse against the rejecting or rescinding buyer by charging the latter's account or by an action for reimbursement or for the repayment of an advance made, as the case may be. Moreover, it would seem that controversies between seller and buyer in respect to variation in quantity, price or value should stand on the same footing as those concerning inferiority in quality. Of course, there is no doubt about the banker's liability to a purchaser of a draft in due course and his consequent right of recourse against the buyer, notwithstanding such variations.

For similar reasons, the fact that the buyer, under the terms of his contract with the seller, has terminated that contract because of the happening or non-happening of a certain event will not enable the buyer to enjoin the banker from performing the promise contained in his letter;[237] nor prevent the banker from paying and having recourse against the buyer.

One is now led to a case in which a shipping or storage document is forged or is not backed by any goods[238] or by goods to which the shipper

indemnitor. See Pan-American Bank & Trust Co. v. National City Bank, 6 F. (2d) 762, 767 (C. C. A. 2d, 1925).

Of course, the terms of the contract may be such that the buyer dispenses with the surrender of shipping documents. Gelpcke v. Quentell, 74 N. Y. 599 (1878) (consignee held liable to banker).

234. Tocco v. Bank of Italy, 249 Mass. 267, 143 N. E. 905 (1924) (guaranty; bank paid on surrender of bill of lading, though it was accompanied by a certificate of inspection showing that the grapes sold were mildewed; the court stressed that only a bill of lading and not a certificate of quality was required; held, that the bank could charge payment against a special account opened by the buyer); Laudisi v. American Exchange Nat. Bank, 239 N. Y. 234, 146 N. E. 347 (1924) (letter of credit; held, that the banker was justified in charging the payment to the account of its customer, the buyer).

235. Agreements between bankers and buyers now often expressly provide that the banker shall not be responsible for the quality of the goods or correctness of the documents. See Nowell v. Equitable Trust Co., 249 Mass. 585, 589 (1924).

236. See *supra* p. 275.

237. Frey & Son v. E. R. Sherburne Co., 193 App. Div. 849, 184 N. Y. Supp. 661 (1st Dep't, 1920) (cancellation of contract because of later sailing). In the writer's opinion, injunctive relief can be had only against the seller.

238. Perhaps goods of a different kind should stand on a like footing.

had title; it may be the seller who perpetrated or participated in wrongful conduct, or someone from whom he innocently purchased the document or goods. In the first place, it seems reasonably clear that the contract between buyer (or consignee) and the banker (or other person) issuing the letter of credit or guaranty is generally not conditioned on the genuineness of the document of title, the actual shipment or storage of the described goods, or the shipper's having title thereto; the consequence being that the banker who in good faith and without knowledge or notice pays or becomes bound by acceptance [239] to pay the draft may have recourse against the buyer. It is the buyer or consignee, and not the issuing banker or his correspondent, who is transacting business with the seller or consignor and who has, or should have, some acquaintance with the latter's honesty and caution. Hence, it is not generally to be inferred that the buyer would have exacted or the banker consented to a condition which would have imposed on the latter the risk of the genuineness and truthfulness of documents of title. It would require a commission appreciably greater than that usually charged for the service to justify a contrary inference.[240] Indeed, it is now commonly provided in the application for the letter of credit that the banker shall not be responsible for the genuineness and truthfulness of shipping documents.[241]

If, however, the issuing banker knows, suspects, or has been notified of such a defect, but nevertheless (not being bound to do so) pays either the seller of the goods or the bona fide purchaser of the draft, he should not have recourse against the buyer. The usual contract between seller and buyer should be so interpreted. In this respect forgery, the absence of goods, or lack of title thereto, may well be distinguished from variations in quality, quantity, price and value; the former are not peculiarly mercantile questions, as are the latter.

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239. Woods v. Thiedemann, 1 H. & C. 478 (Ex. 1862). Arrangement made for consignment of goods by one Homeyer to defendant, who agreed to make advances to Homeyer through *E* bank, correspondent of plaintiff bank. Defendant authorized plaintiff, and plaintiff authorized *E*, to accept draft of Homeyer against bill of lading; plaintiff to receive commission of one-half of one per cent from defendant; *E* accepted and paid the draft; plaintiff reimbursed *E*; bill of lading turned out to be forged by Homeyer. Held, that defendant was liable to plaintiff. See companion case of Thiedemann v. Goldschmidt, 1 DeG. F. & J. 4 (Ch. App. 1859); Gelpcke v. Quentell, 74 N. Y. 599 (1878).

240. Of course, it is firmly established at common law that a bank is not justified in charging its customer's account with the amount of a check on which the name of the drawer or indorser is forged. The protection given by the Bills of Exchange Act, 1882, 45 & 46 Vict. c. 61, § 60, to the bank in the case of a forged or unauthorized indorsement has not been received into the common or statute law of the United States. It is no part of the arrangement between banker and customer that the former may discharge his debt to the latter by paying any and all checks *purporting* to be drawn by the drawer or to be indorsed by one to whose order the drawer has authorized payment. In like manner, if a forged draft were here paid by the issuing bank, it could not charge the account of the buyer or enforce reimbursement or repayment from him.

241. Bank of N. Y. & Trust Co. v. Atterbury Bros., 226 App. Div. 117, 234 N. Y. Supp. 442 (1st Dep't, 1929) (forgery of bills of lading).

VIII. AUTHORITY OF CORPORATIONS TO UNDERTAKE SURETYSHIP RISK [242] IN GENERAL AND TO ISSUE LETTERS OF CREDIT

Unless a corporation be organized to engage in the business of undertaking suretyship risks, or be given specific authority to do so,[243] the general rule is that it has no authority to assume risk, real or personal, merely for the accommodation of another person, whether legal or natural, or to indemnify another against the assumption of such risk.[244] It makes no difference that the corporation receives compensation for the risk, or that the accommodated person is a stockholder.[245] Moreover, this proposition is not affected by Section 29 of the Negotiable Instruments Law, which provides as follows: "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." Interpreted in the light of the common law merchant and Sections 16, 28, 55, 57 and 58 of the same Act, Section 29 must be regarded as conditioned upon the transaction's being free from defect or infirmity. Thus, when the accommodation undertaking is subject to a defect consisting, for example, of fraud, duress, illegality, diversion, or breach of faith, the holder for value does not obtain effective rights thereon so long as any one of the requisites for holding in due course is absent. The same thing is true in respect to ultra vires action; if the holder for value takes an instrument which is irregular or incomplete, or if he takes it after maturity or with knowledge or notice of the ultra vires transaction, he receives no right on the instrument against the corporation.[246]

242. This subject is treated in much detail in 3 THOMPSON, CORPORATIONS (3d ed. 1927) §§ 2280-2305.

243. A "finance" corporation has been held to have such authority. Bennett v. Corporation Finance Co., 258 Mass. 306, 313, 154 N. E. 835, 838 (1927) (". . . to assist financially or otherwise corporations, individuals and others, and to give any guaranty in connection therewith . . ."); Hare & Chase v. Commonwealth Discount Corp., 260 Mass. 134, 137, 156 N. E. 893, 894 (1927) (". . . to conduct the business of financing sales and purchases of automobiles . . ."; held, authority to indorse and guarantee their notes).

244. Commercial Casualty Ins. Co. v. Daniel Russell Boiler Works, 258 Mass. 453, 155 N. E. 422 (1927) (plaintiff, a surety, was obligee in non-negotiable indemnifying bond; held, defendant corporation not bound though plaintiff believed that defendant was "interested" in the transaction between creditor and principal); New Hampshire Nat. Bank v. Garage Co., 267 Mass. 483, 166 N. E. 840 (1929) (accommodation indorsement known to be such by plaintiff-payee); Limerick Mills v. Royal Textile Co., 288 Mass. 479, 193 N. E. 9 (1934); Rodgers v. Krankenhagen, 181 Minn. 306, 232 N. W. 327 (1930); Food Products Co. v. Pierce, 154 Va. 74, 152 S. E. 562 (1930). Many authorities are collected in ANN. CAS. 1913A, 1313; 6 FLETCHER, CYCLOPEDIA CORPORATIONS (Perm. ed. 1931) § 2588.

245. *In re* Romadka Bros. Co., 216 Fed. 113 (C. C. A. 7th, 1914) (accommodated makers owned all the stock); Hess v. Cedarhome Lumber Co., 139 Wash. 107, 245 Pac. 753 (1926) (accommodation joint making of note and execution of mortgage).

246. On the other hand, if the corporation has general power, and the particular officer authority, to execute negotiable instruments in the conduct of its proper business, the holder for value, whether he be the payee or a subsequent transferee, obtains an effective right against the corporation provided that he takes a regular and complete instrument before

Under certain circumstances, however, the assumption of suretyship risk may tend to promote the legitimate purposes of the corporation. Consequently, the rule supported by a majority of the cases is that a corporation is impliedly authorized to undertake suretyship risk if this is a necessary, usual,[247] or reasonably effective means of accomplishing the purposes of the corporation and carrying out the powers explicitly conferred on it;[248] or even, according to some authorities, if its officers reasonably believe that the undertaking is of that nature.[249] Much depends on the circumstances of the particular case. It is difficult to declare, therefore, that any one case is on all fours with another. Nevertheless, the circumstances of numerous cases are so similar that it is possible to draw certain general conclusions from them. Accordingly, by the weight of authority, most corporations for profit may become surety, either as guarantor, obligor, or an accommodation party to negotiate paper, or otherwise, for the obligation of a third person if by thus aiding the latter the corporation is reasonably assured of procuring from him necessary real estate or the use thereof,[250] or needed goods, materials or supplies[251] or the transportation thereof,[252] or his services as an employee;[253] of finding in such person a market for its own goods, prod-

maturity, in good faith and without knowledge or notice that the transaction was one of accommodation and ultra vires; so also, if he knew of the accommodation nature of the transaction but believed that circumstances of benefit were present which would render it intra vires and he had no constructive notice to the contrary. Authorities for these propositions are collected in BRANNAN, NEGOTIABLE INSTRUMENTS (5th ed. by Beutel, 1932) 403-405; Note (1935) 95 A. L. R. 964, 973.

247. Thus, a corporation which has authority to transfer negotiable paper has implied authority to do so in the usual manner, that is, with guaranty or by an indorsement resulting in secondary liability. Hare & Chase v. Commonwealth Discount Corp., 260 Mass. 134, 156 N. E. 893 (1927). It follows that a corporation which buys goods and resells them may take a note from its purchaser payable to the order of the original seller and may deliver it to him with its own indorsement thereon. Ashelman Bros. v. Siebold, 52 N. D. 465, 203 N. W. 176 (1925).

248. Westerfield v. Cream City Brewing Co., 96 Wis. 239, 71 N. W. 101 (1897).

249. Depot Realty Syndicate v. Enterprise Brewing Co., 87 Ore. 560, 170 Pac. 294, *rehearing denied*, 87 Ore. 573, 171 Pac. 223 (1918); *cf.* Bates v. Coronado Beach Co., 109 Cal. 160, 163, 41 Pac. 855, 856 (1895); Fremont Nat. Bank v. Ferguson & Co., 127 Neb. 307, 311, 321, 255 N. W. 39, 41, 45 (1934).

In Eastern Shore Brokerage Comm. Co. v. Harrison, 141 Md. 91, 99, 118 Atl. 192, 195 (1922), it was held that the defence of ultra vires must be specially pleaded.

250. Midland Telegraph Co. v. National Telegraph News Co., 236 Ill. 476, 86 N. E. 107 (1908) (guaranty of rentals due from original lessee to get use of leased property); American Nat. Bank & Trust Co. v. Kushner, 162 Va. 378, 174 S. E. 777 (1934) (accommodation joint making of notes for purchase price of hospital in return for lease thereon given by purchaser).

251. Irwin v. Colburn, 56 Cal. App. 41, 204 Pac. 551 (1922) (accommodation indorsement of notes for rental of land accompanied by lessee's agreement to raise crop and sell it to corporation); Norfolk Mattress Co. v. Royal Mfg. Co., 160 Va. 623, 169 S. E. 586 (1933) (alternative decision).

In Limerick Mills v. Royal Textile Co., 288 Mass. 479, 193 N. E. 9 (1934), all that appeared was that the corporation was accustomed to buy goods from the principal and resell them.

252. Mercantile Trust Co. v. Kiser & Co., 91 Ga. 636, 18 S. E. 358 (1893) (mortgage and, apparently, a guaranty executed by corporation; held valid).

253. Burg & Sons v. Twin City Four Wheel Drive Co., 140 Minn. 101, 167 N. W. 300 (1918) (principal threatened to quit as salesman unless defendant corporation would guarantee the purchase of furniture he desired to buy).

ucts or services;[254] or of obtaining from him payment of a preëxisting debt,[255] or effecting payment of his debt to another person for which the corporation had become bound as surety.[256]

Thus, a brewing company, to induce a liquor dealer to agree to buy its beer and to enable him to fulfill the agreement,[257] may become surety on his public bond,[258] or for the payment of the rent of his place of business,[259] or for his debts incurred for money borrowed or goods or other property bought for use in conducting his business;[260] or may indemnify another person who becomes so bound as surety.[261] Moreover, although there is more conflict among the authorities, a corporation dealing in lumber or other materials may become surety, or indemnify a surety, on a construction bond of a contractor who agrees to purchase from it materials to be used in the work of construction.[262]

There seems to be little doubt that such community of interest is present between a parent and a subsidiary corporation that the former may

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254. Woods Lumber Co. v. Moore, 183 Cal. 497, 191 Pac. 905 (1920); see Edwards v. Pavement Co., 227 Mass. 206, 212, 116 N. E. 266, 268 (1917). *Contra:* Humboldt Mining Co. v. American Mfg. &c. Co., 62 Fed. 356 (C. C. A. 6th, 1894).

Merely to induce good will in the expectation of retaining or attracting business is not sufficient. Proctor v. Opelousas Ins. Agency, 181 La. 79, 86, 158 So. 627, 630 (1934).

255. Armour & Co. v. R. Rosenberg & Sons Co., 36 Cal. App. 773, 173 Pac. 404 (1918); Cudahy Packing Co. v. R. Rosenberg & Sons Co., 36 Cal. App. 818, 173 Pac. 406 (1918); McCarty v. Nostrand Lumber Co., 232 App. Div. 63, 248 N. Y. Supp. 606 (2d Dep't, 1931) (principal corporation heavily indebted to defendant corporation); Mercy v. A. I. Hall & Son, 177 Wash. 338, 31 P. (2d) 1009 (1934) (guaranty of rent of customer, who was indebted to corporation, in consideration of reduction in future rent).

Contra: Proctor v. Opelousas Ins. Agency, 181 La. 79, 158 So. 627 (1934) (a corporate agent's accommodation indorsement of premium notes given to a company by insured now of doubtful solvency, partly to realize agent's commission thereon, was held ultra vires); see Johnson v. Johnson Bros., 108 Me. 272, 295, 80 Atl. 741, 750 (1911).

256. Stromberg-Carlson Telephone Mfg. Co. v. Geo. C. Beckwith Co., 193 Minn. 255, 258 N. W. 314 (1935) (not shown how preceding guaranty was intra vires).

257. In most cases so holding, the liquor dealer agreed to buy the corporation's beer exclusively. It is not sufficient that the corporation is merely seeking to induce his good will in the expectation that he will buy goods. *In re* Liquor Dealers' Supply Co., 177 Fed. 197 (C. C. A. 7th, 1910); see McBroom v. Cheboygan Brewing & Malting Co., 162 Mich. 323, 328, 127 N. W. 361, 363 (1910).

258. Horst v. Lewis, 71 Neb. 365, 98 N. W. 1046 (1904) (liquor dealer was also lessee of saloon from brewing company).

259. Depot Realty Syndicate v. Enterprise Brewing Co., 87 Ore. 560, 170 Pac. 294, *rehearing denied,* 87 Ore. 573, 171 Pac. 223 (1918) (exclusive selling); Westerfield v. Cream City Brewing Co., 96 Wis. 239, 71 N. W. 101 (1897) (exclusive selling); Note (1921) 11 A. L. R. 554, 555.

260. *Cf.* Kraft v. West Side Brewery Co., 219 Ill. 205, 76 N. E. 372 (1906) (loan of money for erection of building in return for agreement of exclusive purchase of beer; held intra vires).

261. Timm v. Grand Rapids Brewing Co., 160 Mich. 371, 125 N. W. 357 (1910) (indemnification of surety on public bond of liquor dealer).

262. Central Lumber Co. v. Kelter, 201 Ill. 503, 66 N. E. 543 (1903); Wheeler, Osgood & Co. v. Everett Land Co., 14 Wash. 630, 45 Pac. 316 (1896) (court also reasoned that this was a usual thing for unincorporated lumber dealers to do and the corporation had to compete with them); Interior Woodwork Co. v. Prasser, 108 Wis. 557, 84 N. W. 833 (1901). *Contra:* Globe Indemnity Co. v. McCullom, 313 Pa. 135, 169 Atl. 76 (1933) (indemnity agreement; alternative decision); W. C. Bowman Lumber Co. v. Pierson, 110 Tex. 543, 221 S. W. 930 (1920).

become surety or indemnitor for the latter.[263] The mere fact, however, that certain persons are stockholders in both corporations does not constitute such community of interest as to justify one corporation in undertaking suretyship responsibility for the other.[264]

It is to be observed that the contemplated benefit may be too remote, indirect or conjectural to bring the suretyship undertaking within the implied authority of the corporation according to the standard above stated.[265] The charter, however, may state the corporate powers in such wide terms as to include remote, indirect and conjectural benefits.[266]

Finally, it may well be that an assumed suretyship or indemnity risk is ultra vires because unreasonably excessive when compared with the benefits to be realized and the resources of the corporation.[267]

In determining the limits of implied authority the various interests involved must be kept in mind. Thus, in all corporations for profit, interests of creditors and the public, as well as of shareholders, are present which demand a proper balance between the preservation and the utilization of resources. Furthermore, in the case of a railroad or other utility, the special duties of public service resting on the corporation and the desirability of preserving its resources to aid in their performance are important factors in ascertaining legislative intention. Moreover, in the case of a bank, and especially a savings bank, the necessity of safeguarding its assets and main-

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263. Henderson Tire & Rubber Co. v. Gregory, 16 F. (2d) 589 (C. C. A. 8th, 1926) (indorsement of trade acceptance); American Surety Co. v. 14 Canal St., 276 Mass. 119, 176 N. E. 785 (1931) (defendant corporation owned all of capital stock of subsidiary; held liable on agreement to indemnify plaintiff, surety on attachment bond of subsidiary corporation); First Nat. Bank v. Pacific Elev. Co., 159 Minn. 94, 198 N. W. 304 (1924) (defendant corporation owned nearly half of stock of subsidiary); First Nat. Bank v. Guardian Trust Co., 187 Mo. 494, 86 S. W. 109 (1905) (defendant corporation stockholder, creditor, and financial backer of principal); 3 THOMPSON, CORPORATIONS (3d ed. 1927) §§ 2380, 2381.

It by no means follows, however, that the subsidiary corporation may go surety for the controlling corporation. Wm. Filene's Sons Co. v. Gilchrist Co., 284 Fed. 664 (C. C. A. 1st, 1922) (majority of stock owned).

264. Johnson v. Johnson Bros., 108 Me. 272, 80 Atl. 741 (1911).

265. Wm. Filene's Sons Co. v. Gilchrist Co., 284 Fed. 664 (C. C. A. 1st, 1922) (guarantee of rentals so that defendant corporation might have a "friendly competitor" on opposite corner; held ultra vires); Western Maryland R. R. v. Blue Ridge Hotel Co., 102 Md. 307, 62 Atl. 351 (1905) (agreement by railroad corporation with hotel corporation to make up deficit in interest and dividends; held ultra vires, though patrons of hotel would travel by this railroad); Davis v. Old Colony R. R., 131 Mass. 258 (1881) (agreement by railroad corporation to contribute toward deficit in conducting music festival; held ultra vires, although persons in attendance might use railroad); Davis v. Smith American Organ Co., 131 Mass. 258 (1881) (same, although persons attending might buy corporation's products).

266. Fremont Nat. Bank v. Ferguson & Co., 127 Neb. 307, 255 N. W. 39 (1934) (". . . to do all acts or things necessary, incidental or convenient to do, or calculated, directly or indirectly, to promote the interests of the company . . ."; accommodation indorsement of note of *X* Co. given in renewal and discharge of a former note made by *X* Co. and indorsed by *Y*, both *X* Co. and *Y* being indebted to this corporation; held intra vires). *Contra:* Limerick Mills v. Royal Textile Co., 288 Mass. 479, 193 N. E. 9 (1934) (similar charter; it merely appeared that principal was accustomed to buy goods of defendant corporation).

267. Globe Indemnity Co. v. McCullom, 313 Pa. 135, 169 Atl. 76 (1933) (indemnity agreement with surety on completion bond of contractor, defendant corporation to sell lumber for building; amount of bond several times net worth of defendant).

taining its solvency in the interest of depositors and, indeed, of the general public, points even more strongly to restrictive legislative intention; and, if the bank is doing a trust business, the protection of beneficiaries is an added restrictive factor.[268] Hence, as a general rule, a national or other banking corporation is not impliedly authorized to become surety for the obligation of another person,[269] for instance, by indorsement, guaranty,[270] promise to purchase an obligation on default or promise to honor a check or other bill,[271] merely because the success of his business might or would promote its own.[272] There are, however, recognized instances of implied authority even in the case of the banking corporation:

(1) A banking corporation having authority to negotiate bills and notes which it owns has implied authority to effect negotiation in the usual way, that is, through a guaranty or an indorsement involving secondary liability.[273] Moreover, although the bank is not owner of the instrument and its indorsement thereof is for the accommodation of another person, still, under the rules governing negotiable instruments, if the transaction between the bank and the holder purports to be one of transfer and the

268. See Knass v. Madison & Kedzie State Bank, 354 Ill. 554, 564, 188 N. E. 836, 841 (1934).

269. MAGEE, BANKS & BANKING (3d ed. 1921) § 248; 1 MORSE, BANKS & BANKING (6th ed. 1928) § 65.

270. Commercial Nat. Bank v. Pirie, 82 Fed. 799 (C. C. A. 8th, 1897) (alternative decision); Bowen v. Needles Nat. Bank, 87 Fed. 430 (S. D. Cal. 1898), *aff'd*, 94 Fed. 925 (C. C. A. 9th, 1899), *cert. denied*, 176 U. S. 682 (1900); Thilmany v. Iowa Paper Bag Co., 108 Iowa 333, 79 N. W. 68 (1899) (national bank); see Kirkman v. Farmers Savings Bank, 28 F. (2d) 857, 861 (C. C. A. 8th, 1928); *cf.* First Nat. Bank v. National Produce Bank, 239 Ill. App. 376 (1926).

271. Merchants Bank of Valdosta v. Baird, 160 Fed. 642 (C. C. A. 8th, 1908) (national bank); Swenson Bros. Co. v. Commercial State Bank, 98 Neb. 702, 154 N. W. 233 (1915).

Thus, a banking corporation has no implied authority to certify a check or accept a bill for accommodation. In Ingersoll v. Kansas State Bank, 110 Kan. 122, 202 Pac. 839, *rev'g*, 109 Kan. 534, 202 Pac. 837 (1921), it was held that under the Kansas statute a banking corporation did not have authority to accept a time draft for any purpose and hence that even a bona fide purchaser without knowledge or notice of accommodation could not recover against the bank. And see American Express Co. v. Citizens State Bank, 181 Wis. 172, 176, 194 N. W. 427, 428 (1923) (simple acceptance of time draft held ultra vires, though bank had power to issue letters of credit).

272. Notes (1911) 32 L. R. A. (N. S.) 544, L. R. A. 1918A 415.

273. People's Bank v. National Bank, 101 U. S. 181 (1879) (court placed no reliance on fact that the indorsing bank applied the proceeds in payment of its own claim against the maker); Cochran & Sayre v. United States, 157 U. S. 286 (1895); Farmers & Miners Bank v. Bluefield Nat. Bank, 11 F. (2d) 83 (C. C. A. 4th, 1926); Central Metropolitan Bank v. Chippewa County State Bank, 160 Minn. 129, 199 N. W. 901 (1924) (guaranty); Farmers & Merchants State Bank v. Mellum, 173 Minn. 325, 217 N. W. 381 (1928) (alternative decision).

The NATIONAL BANKING ACT, 13 STAT. 99 (1864), 12 U. S. C. A. § 24 (1927), provided that the banking association was authorized "to . . . exercise . . . such incidental powers as shall be necessary to carry on the business of banking by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt. . . ."

It is also probably true that a banking corporation having authority to assign a nonnegotiable bond, bill, note, or other chose in action may enter into a guaranty of payment or collectibility in doing so. See Thilmany v. Iowa Paper Bag Co., 108 Iowa 333, 336, 79 N. W. 68, 69 (1899); Talman v. Rochester City Bank, 18 Barb. 123, 135 (N. Y. 1854).

Furthermore, it has been held a transferring state bank may enter into an agreement to repurchase commercial paper on demand. First State Bank v. First State Bank, 165 Minn. 285, 206 N. W. 459 (1925). Many cases are collected in ANN. CAS. 1916D, 554, 559.

latter takes the instrument for value, before maturity, in good faith and without knowledge or constructive notice that the indorsement is actually for accommodation, the holder gains an effective right against the bank.[274]

It is obvious, however, that a banking corporation which acts merely as agent in issuing or transferring a note, bond, or other chose in action, although for compensation, is not impliedly authorized to indorse or guarantee the same, or to agree to repurchase it on default or before or after maturity at the election of the holder or on some other contingency.[275]

While the assumption of secondary liability is the usual method of effecting the negotiation of commercial paper, it is unusual in the transfer of long-term corporate bonds and notes, secured or unsecured, or other forms of investment securities.[276] Hence, as a general rule, a banking corporation does not have implied authority to assume suretyship risk in respect thereto.[277] This proposition is reflected in the amendment of February 25, 1927,[278] to Section 5136 of the Revised Statutes of the United States relating to national banking associations, which amendment provided that "the business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse marketable obligations evidencing indebtedness of any person . . . or corporation, in the form of bonds, notes and/or debentures, commonly known as investment securities." Under this amendment it was held in *Awotin v. Atlas Exchange*

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274. If these were the facts in People's Bank v. National Bank, 101 U. S. 181 (1879), cited *supra* note 273, the case can also be rested on that ground.

The same thing has been held in respect to a guaranty accompanying an apparent sale of a note. Beyl v. Swanson, 165 Minn. 278, 280, 206 N. W. 453, 454 (1925).

The same principle governing negotiable instruments led to the decision in Atterbury v. Bank of Washington Heights, 241 N. Y. 231, 238, 149 N. E. 841, 843 (1925), in which case the defendant banking corporation was held liable on its acceptance of a draft having more than one year to run, purporting to be a trade acceptance but in fact given for the accommodation of the drawer-payee, and negotiated by him to the plaintiff, holder in due course; the court stated as a reason that a banking corporation has authority to purchase goods of certain kinds and assume a negotiable obligation therefor.

275. Knass v. Madison & Kedzie State Bank, 354 Ill. 554, 569, 188 N. E. 836, 842 (1934) (corporate bonds secured by mortgage on real estate); Farmers & Mechanics Savings Bank v. Crookston State Bank, 169 Minn. 249, 210 N. W. 998 (1926); Federal Land Bank v. Crookston Trust Co., 180 Minn. 319, 230 N. W. 797 (1930).

276. Indeed, mortgage notes and bonds of non-corporate origin might well be included in the category of investment securities, but it was held in Beyl v. Swanson, 165 Minn. 278, 206 N. W. 453 (1925), that a state bank had implied authority to guarantee payment of a mortgage note which it sold and transferred. By TEX. STAT. (1928) art. 396, a bank may sell and guarantee bills of exchange, bonds and mortgages and other securities.

277. In the writer's opinion, the line of demarcation should not be drawn between order and bearer instruments, since the former may be indorsed with secondary liability excluded and the latter transferred with secondary liability assumed; nor between corporate and non-corporate obligations; nor between a single corporate obligation and one or more of many corporate obligations of the same issue; but rather between commercial paper and investment securities: the accumulation of long-term risks which would be involved in the business of guaranteeing the latter seems to be the determinative factor.

It is to be observed that the authority of a banking corporation to assume a debt secured by mortgage on land conveyed to it involves a question quite different from those now under consideration, for the assumption, if valid, renders the corporation a principal debtor. See Note (1934) 91 A. L. R. 177.

278. 44 STAT. 1226 (1927), 12 U. S. C. A. § 24 (Supp. 1935).

Nat. Bank [279] that an agreement made to repurchase corporate mortgage bonds at maturity at the holder's option was ultra vires,[280] that a national banking corporation was not contractually liable thereon under the doctrine of "estoppel" or otherwise, and that the statutory provision against recourse also excluded a right to restitution of the purchase price on tender of a return of the bonds. Likewise, in *Greene v. First Nat. Bank,*[281] in an action brought by a purchaser of real estate mortgages, and seemingly, of the notes secured thereby, it was soundly held that no recovery could be had on an agreement made by the seller, a national banking corporation, to repurchase the mortgages at any time on demand, in view of the federal statutory provision that, while a national bank may act as broker in making or procuring loans on real estate, "no such bank shall *in any case* guarantee either the principal or interest of any such loans [that is, on real estate]." [282] While the agreement, since it was to repurchase *at any time,* was not one of suretyship in form or substance, it was in truth more onerous, although perhaps not so insidious. At all events it was so unusual and so dangerous as to be ultra vires and void.[283] Whether quasi-contractual recovery could be had in that situation is a closer question. True, such recovery might be different in amount from the agreed repurchase price, and, as far as the particular transaction is concerned, would result in the bank's being placed in exactly the same position as it was in before the transaction took place. On the other hand, in the writer's opinion, the policy of deterrence is so strong here as to forbid all redress, restitutional as well as contractual; such a practice would be much more dangerous than that of guaranteeing commercial paper in that it would lead to an accumulation of long-term risks.

(2) It has been held that a national or other banking corporation has implied authority to become surety, or to indemnify a surety, in respect to a loan made to another person,[284] if the agreement is that the entire proceeds shall be paid directly or indirectly to the bank, and be applied on a previous indebtedness owed to it by the borrower.[285] Moreover, even if

279. 295 U. S. 209 (1935).

280. By amendment of June 16, 1933, 48 STAT. 184, 12 U. S. C. A. § 24 (Supp. 1935), it is provided that a national banking association may purchase for its own account investment securities under such restrictions as the Comptroller of the Currency may prescribe, with certain limitations as to the amount of any one issue depending on the capital and surplus.

281. 172 Minn. 310, 215 N. W. 213 (1927).

282. 39 STAT. 753 (1916), 12 U. S. C. A. § 92 (1927). (Italics added.)

283. Accord: Knass v. Madison & Kedzie State Bank, 354 Ill. 554, 188 N. E. 836 (1934); Hoffman v. Sears Community State Bank, 356 Ill. 598, 191 N. E. 280 (1934); Note (1929) 60 A. L. R. 818.

284. Or for the payment of a note or bond owned by another person and transferred or assigned with or without obligation on his part to the creditor. See Talman v. Rochester City Bank, 18 Barb. 123, 138 (N. Y. 1854) (guaranty of collectibility given by banking corporation).

285. Modoc County Bank v. Ringling, 7 F. (2d) 535 (C. C. A. 9th, 1925) (state bank); Ellis v. Citizens Nat. Bank, 25 N. M. 319, 183 Pac. 34 (1919) (recovery on written guaranty; action in quasi-contract would have been barred by Statute of Limitations).

the transaction be regarded as ultra vires, still, under the so-called doctrine of "estoppel" prevailing in many state courts, though not in the United States courts,[286] the transaction having been fully executed on the part of the creditor or indemnitee and the banking corporation having received the full benefit thereof, the latter is contractually bound to the former.[287] At any rate, although a court should deny the existence of a contractual right, still, the money having been applied in payment of the debt due to the banking corporation, the creditor or indemnitee could have quasi-contractual recovery against it because of the benefit thus received.[288] While ultra vires action is a wrong to the public as well as to creditors and shareholders, it is not necessarily immoral, and the normal consequences of this kind of illegality are not so serious as to forbid restitution.[289] Indeed, if but part of the proceeds of the loan were applied on the debt, the creditor would have to resort to quasi-contractual redress, which would, of course, be limited to the amount so applied;[290] for, on principle, even under the theory of "estoppel," contractual recovery should not be given either in whole or part

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Likewise, if only part of the proceeds is paid to the bank, provided that the bank's liability as surety is so limited that it will not exceed that part. Park Falls State Bank v. Fordyce, 206 Wis. 628, 238 N. W. 516 (1932).

286. Consequently, the doctrine referred to has no application to national banks even in state courts. "In this case the defendant pleads that it had no power under the National Banking Act [13 STAT. 99 (1864), 12 U. S. C. A. § 24 (1927)] to enter into a contract with the plaintiff bank—which is likewise a national bank—that the draft of Lieuallen on Clemons & Company would be paid, because such a contract was a mere guarantee, and that it was ultra vires of its power to make such a contract. The plaintiff replies that the defendant is estopped to plead ultra vires, among other reasons, because the contract is an executed contract on the part of the plaintiff, and because only the Government can question the power of the defendant to enter into such a contract. . . . It will be of no profit in this case to consider the rules of law adopted by the several States bearing upon the power of banks organized by authority other than the Federal government to enter into such contracts, or to interpose the defense of ultra vires after the other party to the contract has fully performed it, for the decisions of the Federal courts treat all such contracts as void and unenforceable as to the national banks, and this court is in duty bound to defer to those Federal decisions." First Nat. Bank v. American Nat. Bank, 173 Mo. 153, 159, 163, 72 S. W. 1059, 1061, 1062 (1903), quoted with approval in First Nat. Bank v. Monroe, 135 Ga. 614, 619, 69 S. E. 1123, 1125 (1911).

287. Appleton v. Citizens Central Nat. Bank, 190 N. Y. 417, 83 N. E. 470 (1908) (reasoning); First Nat. Bank v. Womack, 56 Okla. 359, 156 Pac. 207 (1916) (alternative decision).

288. Consolidated Nat. Bank v. Anglo & London, Paris Nat. Bank, 34 Ariz. 160, 269 Pac. 68 (1928) (held plaintiff confined to this redress); First Nat. Bank v. Womack, 56 Okla. 359, 156 Pac. 207 (1916) (alternative decision); Oklahoma City Nat. Bank v. Ezzard, 58 Okla. 251, 159 Pac. 267 (1916).

Of course, if the indemnitee (or creditor) was a director or other officer of the bank and liable to it in the amount of the prior indebtedness because of breach of common law or statutory duty in respect thereto, for example, because it exceeded a statutory limit, quasi-contractual recovery would be denied even though action in tort against him for such breach would be barred by the Statute of Limitations. McQueen v. First Nat. Bank, 36 Ariz. 74, 283 Pac. 273 (1929).

289. See Oklahoma City Nat. Bank v. Ezzard, 58 Okla. 251, 258, 159 Pac. 267, 269 (1916).

290. Citizens Central Nat. Bank v. Appleton, 216 U. S. 196 (1910), *aff'g*, 190 N. Y. 417, 83 N. E. 470 (1908).

because the benefit received by the corporation was patently less than full benefit.[291]

The principle of restitutional redress is well illustrated by *First Nat. Bank v. Mott Iron Works*.[292] In that case the defendant national bank, having lent money to a building contractor on the security of an assignment of the latter's right to the contract price, guaranteed payment for certain goods sold by the plaintiff to the contractor, the defendant's purpose being to enable the contractor to perform his undertaking and thus render the contract price available to the defendant. The goods went into the building and the contractor eventually received part of the contract price which he applied in pro tanto satisfaction of the loan. It may well have been that the banking corporation had no authority to enter this contract of guaranty since conceivably the goods might go into the building and yet defendant's loan remain unpaid because, for example, the contract price was so low or the goods were so improvidently used that little or nothing thereafter became due on the contract.[293] Nevertheless, since these goods went into the building and in fact contributed [294] to the enhancement of the amount available to the defendant corporation, and such enhancement equaled the guaranteed cost of the goods, it was properly held that the plaintiff was entitled to quasi-contractual recovery in the latter amount.[295]

A case may be supposed in which both the borrower and the guaranteeing bank are corporations without authority to enter into, and not contractually bound by, the later transaction of loan (although the borrowing corporation had authority to incur the previous indebtedness to the bank); the creditor would then have a quasi-contractual right against each corporation: against the debtor because of benefit received by it in the discharge of its obligation,[296] and against the guarantor because of benefit received through the performance thereof [297]—a performance which otherwise it

291. First Nat. Bank v. Monroe, 135 Ga. 614, 69 S. E. 1123 (1911) (part applied in payment of debt to corporation; question of quasi-contractual recovery left unanswered).

292. 258 U. S. 240 (1922).

293. It must be conceded, however, that courts have been rather liberal in respect to the authority of a national or other banking corporation to undertake suretyship liability as a hopeful means of procuring payment of indebtedness due from an insolvent contractor. Norton Grocery Co. v. Peoples Nat. Bank, 151 Va. 195, 144 S. E. 501 (1928); Second Nat. Bank v. United States Fidelity & Guaranty Co., 266 Fed. 489 (C. C. A. 4th, 1920).

294. While labor and other materials undoubtedly helped to produce the enlargement of the amount due, it did not appear that the claims therefor were a prior or other lien on the fund or that there was a surety for such claims who had a prior lien on or other interest in the fund; and, indeed, although there had been such priorities in the fund, still any surplus would have been available to the bank and thus have constituted a benefit sufficient for quasi-contractual recovery pro tanto.

295. It is true that the defendant corporation actually received less, but this was because it had permitted the contractor to take and expend part of the contract price; the point is that the value of the defendant's security right had been increased by as much as the guaranteed cost of the goods.

296. Aldrich v. Chemical Nat. Bank, 176 U. S. 618 (1900) (transaction assumed to be beyond the authority of officer and corporation).

297. Citizens Central Nat. Bank v. Appleton, 216 U. S. 196 (1910), *aff'g*, 190 N. Y. 417, 83 N. E. 470 (1908).

probably would not have received; but, of course, performance eventually rendered by the borrower to the creditor would discharge the quasi-contractual obligation of the guarantor, and performance rendered by the guarantor would subrogate him to the creditor's right against the borrower.[298]

(3) The question may now be asked whether a banking corporation is authorized to guarantee a loan to the end that the borrower may relend the money to the corporation. The writer would answer the question in the negative if the circumstances are such that the corporation thereby incurs a double risk, for example, if the loan to it matures before the first, or if it gives its negotiable bill or note to evidence the same; for the corporation may have to pay the first loan as guarantor thereof and then find it impossible to assert its right of reimbursement as a set-off to an action on the second—in the former case because its cause of action for reimbursement may have arisen too late,[299] and in the latter case because the action against it might be brought by a transferee of the bill or note.[300] In such cases, however, contractual recovery might be given in some states on the ground that the creditor had fully executed the first transaction of loan and the corporation is "estopped" by having received the proceeds.[301] Quasi-contractual recovery would seem to be excluded because of absence of benefit; for the money received by the corporation is balanced by the indebtedness it incurred therefor.

Consideration may now be given to the question whether a banking corporation [302] is impliedly authorized to issue letters of credit. This question has been answered in the affirmative,[303] but the writer submits that the negative is the better position.[304] It should be observed in the very begin-

298. Really, in respect to these quasi-contractual obligations, borrower and guarantor are principal and surety, respectively, though nonconsensually so, since the borrower was originally indebted to the bank.

299. For set-off in case of bankruptcy and other proceedings in insolvency, see CAMPBELL, CASES ON SURETYSHIP (1931) 284, 285, n. 2.

300. Statutes of set-off usually require mutuality; see CAMPBELL, CASES ON BILLS & NOTES (1928) 591-595.

301. If First Nat. Bank v. Womack, 56 Okla. 359, 156 Pac. 207 (1916), cited *supra* note 287, is such a case, it would have to be rested on this ground.

302. Of course, the issue of letters of credit is within the implied authority of a corporation engaged in the business of buying goods or receiving and selling the same on commission. Armour & Co. v. Belton Nat. Bank, 22 F. (2d) 727 (C. C. A. 5th, 1927), *cert. denied*, 276 U S. 636 (1928). These letters differ materially from those treated in the text.

303. Russell Grader Mfg. Co. v. Farmers Exchange State Bank, 49 N. D. 999, 194 N. W 387 (1923) (arguendo).

304. One court has taken the position that despite the suretyship nature of the bank's undertaking, a bona fide purchaser without knowledge thereof has an effective right against the banking corporation. Bridge v. Welda State Bank, 222 Mo. App. 586, 292 S. W. 1079 (1927). The writer ventures to criticize this decision. While the promise ran to the plaintiff it is not negotiable, and at all events the promisee should be put on notice of the ultra vires character of the letter, since almost invariably its purpose is to lend credit and the bank is not in funds at the time the letter is issued.

It seems to be generally recognized that national banks had no authority to issue letters of credit before the Federal Reserve Act of 1913 [38 STAT. 251 (1913), 12 U. S. C. A. § 221 *et seq.* (1936)]. See FINKELSTEIN, *op. cit. supra* note 139, at 5, n. 7.

ning that a banker may conceivably make various kinds of commitments, including, first, a present loan of money, which is undoubtedly one of a banker's primary and legitimate functions; secondly, a contract to lend money in the future; thirdly, a lending of credit by assuming suretyship risk; fourthly, a lending of credit by undertaking to indemnify one person against risk incurred in aid of another. The second kind of commitment is more beguiling than the first, because the banker is likely to contract to lend in the belief that he will have ample funds by the specified time, and may well be regarded as beyond the implied authority of a banking corporation; and the third and fourth are more insidious [305] than the second because the banker is likely to rely on another's performance, and are generally held to be outside of implied corporate banking authority.[306] Letters of credit may involve the second or third type of commitment; the second, when the banker and the buyer contemplate that payment in pursuance of the letter will constitute an advance to the buyer to be repaid by him at a future date, and the third, when, as is usually the case, the agreement is that the buyer will put the banker in funds at or before the time of payment.

The fact that the promise of the letter of credit is primary in form, rather than secondary (as in an indorser's or guarantor's), does not exclude suretyship, or lessen the risk of the issuing bank or the temptation to incur a dangerous accumulation of liabilities. And, while it has been argued with considerable force [307] that the needs of the times and the changing attitude toward the banker's function tend to expand the content of the general grant of banking powers, the writer submits that the experience of recent years points to solvency as the paramount need. The solution of the matter lies more properly in the field of legislation, where appropriate requirements as to security and limitations on commitments, aggregate and individual, may be laid down. Accordingly, in many jurisdictions statutes now explicitly authorize banking corporations to issue "letters of credit," and in that case it is clear that the corporation may undertake either the second or third kind of commitment.[308] The letter of credit referred to by such statutes seems to be the more or less formal writing which in modern times

305. For a graphic statement of the dangers involved see 1 MORSE, BANKS & BANKING (6th ed. 1928) § 65, n. 19.

306. See *supra* p. 282.

307. FINKELSTEIN, *op. cit supra* note 139, at 5, n. 7.

308. The following are typical statutes providing in effect as below stated: 41 STAT. 378 (1919), 12 U. S. C. A. §§ 611-615 (1927): A corporation organized to engage in international or foreign banking shall have power ". . . to purchase or sell, with or without its indorsement or guaranty, securities, including obligations of the United States or of any state thereof . . . to accept bills or drafts drawn upon it . . . to issue letters of credit. . . ." For provisions affecting members of the Federal Reserve System see *infra* note 310.

N. Y. CONS. LAWS (Cahill, 1930) c. 3, art. 3, § 106 (2): A bank shall have authority ". . . to accept for payment at a future date drafts drawn upon it by its customers and to issue letters of credit authorizing holders to draw drafts upon it or its correspondents at sight or on time not exceeding one year . . .", with limitations upon the credit to be extended or lent to one person, firm, or corporation.

has come to bear the name in banking and commercial practice. Its promise is normally primary in effect, and thus to be distinguished from a guaranty, which is a promise to pay if another does not fulfill his obligation or liability to pay. Words, however, are not conclusive in interpretation. The writing may contain the word "guarantee" and yet be a letter of credit; [309] it may be entitled a "letter of credit" and yet be a guaranty.[310]

While the federal statutes do not in terms permit national banks to issue letters of credit, they do authorize member banks of the Federal Reserve System (including national banks), within specified limits, to accept drafts growing out of transactions of import or export, or involving the domestic shipment of goods.[311] It is generally and properly recognized that such banks are thus impliedly authorized to issue letters of credit promising such acceptance and not transgressing the limits therefor; for no additional risk is involved, and a letter of credit is a common feature of such transactions and precursor of the acceptance given therein.[312]

MASS. ACTS (1933) c. 172, §§ 36, 37: A trust company may ". . . accept for payment at a future date bills drawn upon it and issue letters of credit authorizing holders to draw drafts upon it or its correspondents at sight or on time; provided such drafts be based on actual values . . .", with limitations as to aggregate amount of such commitments.

CAL. GEN. LAWS (Deering, 1931) Act 652, § 80: Similar to 12 U. S. C. A. § 372 (1927). Also, indirect reference to letters of credit.

LA. GEN. STAT. ANN. (1932) §§ 543, 654: Banks and trust companies are authorized to accept drafts, etc., and to issue letters of credit authorizing, etc., with limitation as to any one customer to the amount which it would be permissible to lend to him (which, under § 566, is 20 per cent of capital and surplus unless loan is secured by collateral; maximum limit of one-half capital and surplus, or entire capital and surplus in case of commodity loan).

MD. ANN. CODE (Bagby, 1924) art. 11, § 23: Power to issue letters of credit, etc. (originating in Laws of 1910, c. 219, § 23); also provision similar to Federal statute.

MO. STAT. ANN. (1932) c. 34, § 5354 (2): Similar to New York.

N. J. COMP. STAT. (Cum. Supp. 1911-1924) § 17-6a: Power to accept drafts, etc., and to issue letters of credit, etc., with limitations as to credit lent to any one person.

OHIO CODE ANN. (Throckmorton, 1934) §§ 710-137: Banking corporations may accept drafts for payment at a future date growing out of importation or exportation of goods, and may issue letters of credit, under specified restrictions.

309. Border Nat. Bank v. American Nat. Bank, 282 Fed. 73 (C. C. A. 5th, 1922) ("guaranty" held not to be incompatible with letter of credit).

310. FINKELSTEIN, *op. cit. supra* note 139, at 35, 36. But not all writings promising payment in the first instance are letters of credit; thus, many agreements for indemnity in the form of exoneration fall outside the classification of letters of credit.

311. 38 STAT. 958 (1915), 12 U. S. C. A. § 372 (1927): Any member bank [of the Federal Reserve System] may accept drafts payable not more than six months after sight which grow out of transactions involving the importation or exportation of goods; or which grow out of transactions involving the domestic shipment of goods, provided that shipping documents or warehouse receipts are attached at the time of acceptance; the credit to be thus lent to a particular person, firm or corporation to be limited to a certain percentage of capital and surplus unless the bank is secured by attached documents, and the aggregate of all such commitments to be limited to one-half of capital and surplus.

Similar statutory provisions in various states are exemplified by MD. ANN. CODE (Bagby, 1924) art. 11, § 23; IOWA CODE (1935) § 9272.

Other statutes enabling a bank to accept drafts, without regard to transactions of import or export or of domestic shipment, are CONN. GEN. STAT. (1930) § 3901 (with limitations as to aggregate and any one person); TEX. STAT. (1928) § 1513 (with limitations as to aggregate); MICH. COMP. LAWS (1929) § 11901 (with limitations as to aggregate).

312. Conversely, statutory authority to issue letters of credit should be taken to import authority to accept drafts payable a certain time after date or sight. But *cf.* American Express Co. v. Citizens State Bank, 181 Wis. 172, 194 N. W. 427 (1923). FINKELSTEIN, *op. cit. supra* note 139, at 5, n. 7.

It remains to consider whether a banking corporation which has authority to issue letters of credit may properly assume liability to a banker who issues a letter at its request. This question has been answered in the negative when the undertaking is to guarantee performance of the obligation of the purchaser of goods to the issuing banker.[313] In *Pan-American Bank & Trust Co. v. National City Bank,*[314] however, it was held that an undertaking on the part of the defendant trust company,[315] arising from correspondence, to pay the plaintiff bank such amount as it might have to pay out on a letter of credit issued by it, was not a guaranty [316] and hence not ultra vires. Two questions seem to have been raised by this case. The first was, did common law principles of ultra vires permit the undertaking of the defendant, the sponsoring bank? The writer would answer in the negative. It would seem to be immaterial whether the buyer was under an obligation to the issuing banker for the performance of which the defendant purported to undertake suretyship risk as guarantor or otherwise; or whether the buyer agreed only to place the defendant in funds, and the latter to put the issuing banker in funds or otherwise indemnify him. Either is a commitment of the fourth type above mentioned,[317] and officials of the sponsoring bank are likely to rely on exoneration through performance rendered by the buyer, in the one case to the issuing banker and in the other to the defendant.[318] The second question is whether the statutory power to issue letters of credit carries an implication of authority to enter into an undertaking of indemnity with the issuing bank. The answer must probably be in the negative, because such an arrangement is in lieu and not in aid of the specified power; and also, as is pointed out by L. Hand, J., in his able dissenting opinion in the *Pan-American Bank* case, "the stronger credit and wider reputation" of the issuing bank is likely to bring to the sponsoring bank an excessive aggregate of risks and hence to be its undoing.[319] Lastly, however, a situation may be supposed in which the indemnity arrangement takes the form of a writing, delivered to the issuing bank either directly or

313. Nowell v. Equitable Trust Co., 249 Mass. 585, 144 N. E. 749 (1924) (MASS. GEN. LAWS (1932) c. 172, §§ 36, 37, provided that the trust companies "may accept drafts growing out of transactions involving the import or export of goods", and "may accept drafts drawn on it and issue letters of credit authorizing holders thereof to draw drafts on it, or its correspondents, at sight or on time").

314. 6 F. (2d) 762 (C. C. A. 2d, 1925), *cert. denied,* 269 U. S. 554 (1925).

315. This trust company was organized under the laws of Louisiana.

316. Indeed, the fact appeared to be that the buyer was not obligated to the issuing bank, and hence the defendant was not a surety of any kind.

317. See *supra* note 303.

318. Moreover, if the sponsoring bank and the buyer have in effect agreed on an advance later to be repaid, the undertaking of the sponsoring bank, being one of the second type of commitment, may involve too much danger to depositors and hence be ultra vires.

319. The writer believes, however, that there is usually a limit to the credit which the sponsoring bank has with the issuing bank, and this has a counteracting effect. Moreover, Judge Hand's reason would lose much of its cogency in states where there is a fairly strict limit on such transactions. The limit prevailing in Louisiana, however, is quite liberal. See *supra* note 308.

through the buyer, and authorizing the issuing bank to draw on the sponsoring bank for the amount of drafts paid or to be paid;[320] or promising to pay such amount on delivery of shipping documents without resort to the device of drawing.[321] Either form of writing seems to be a letter of credit, as distinguished from a mere guaranty or indemnity undertaking, and thus to be authorized under a statutory power to issue letters of credit.[322]

320. For the purposes of the present question, this writing resembles a straight letter of credit addressed to correspondent bank with authority to confirm the credit. FINKELSTEIN, *op. cit. supra* note 139, at 302; McCurdy, *Commercial Letters of Credit* (1922) 35 HARV. L. REV. 539, 556.

321. Second Nat. Bank v. Columbia Trust Co., 288 Fed. 17, 20 (C. C. A. 3d, 1923).

322. In 7 FED. RES. BULL. (1921) 547, it has been suggested that the sponsoring bank, as undisclosed principal, might perhaps properly appoint the other bank its agent to issue the letter, the result being that both banks would be bound thereon and the former would come under agreed or relational duties of exoneration and reimbursement to the latter. In Brown v. Mt. Holly Nat. Bank, 288 Pa. 478, 136 Atl. 773 (1927), and Southwark Nat. Bank v. Mt. Holly Nat. Bank, 288 Pa. 491, 136 Atl. 777 (1927), the question of ultra vires was not decided, but only that a cashier, merely by virtue of his office, had not authority to appoint a correspondent banker as its agent to issue the letter.