

THE IMPLIED POWER OF NATIONAL BANKS TO ISSUE LETTERS OF CREDIT AND ACCEPT BILLS

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THE scope of the implied powers of National Banks is a recurrent issue as the functions of banks continue to grow with new developments in business, and as the banks which are under less conservative management extend their services into fields farther and farther removed from established banking practices.¹ Recently it has become necessary to reexamine the nature of the implied powers of National Banks in order to defend their power to issue sight and time letters of credit.² The letter of credit has in the past few years become a major

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1. See New York Atty. Gen. Goldstein's opinion of Jan. 20, 1947, that New York banks may not carry on a travel agency business, N.Y. BKG. LAW §96 note 22 (McKinney, 1948 Supp.); cf. Rule No. 67 of the Comptroller of the Currency, C.C.H. FED. BKG. LAW REP. ¶90,426 (1947). The power of banks "to extend their functions and perform services formerly foreign to the banking business" (*Dyer v. Broadway Central Bank*, 252 N.Y. 430, 433, 169 N.E. 635, 636 (1930)) is best justified when it is exercised merely in new applications of an old power inherent in the business of banking, such as a bank's power to lend its credit. *Block v. Pennsylvania Exch. Bk.*, 253 N.Y. 227, 230, 170 N.E. 900, 901 (1930); cf. *Whiting v. Hudson Trust Co.*, 234 N.Y. 394, 406, 138 N.E. 33, 37 (1923); *Bank of California v. Portland*, 157 Ore. 203, 69 P.2d 273 (1937), cert. denied, 302 U.S. 765 (1938) (safe-deposit-box business held now within the implied banking powers of national banks); *Henderson v. Henderson*, 109 F.2d 863, 866 (9th Cir. 1940); AIGLER, CASES ON BILLS AND NOTES 74 n. 21 (1947). The legality of any other new functions is not relevant to the subject of this article.

2. In the view of the writer, a letter of credit (sometimes formerly called a bill of credit) is a written communication (including such a writing as a cablegram) which (in the circumstances in which it is sent) shows the intent of the issuer (the writer or sender) to request a third party (the correspondent), specifically or as one or more of a group, to pay money, or to make the correspondent's credit available, to a beneficiary named therein, upon the credit of or against payment by the issuer. (It is usually addressed to the beneficiary or the correspondent.) It has some similarity to the bill of exchange (drawn upon the correspondent to the order of the beneficiary) but it is a request, not an order, is usually conditional, and need not require a payment in cash to the beneficiary (of a sum certain or other sum), or be limited to being honored on demand or, in the alternative, at a fixed or determinable future time. A mere advice from a bank that it will honor drafts drawn upon it by the addressee normally implies the necessary request, to any (unnamed) negotiator of the drafts, in order to constitute the advice a letter of credit and to create a direct and primary obligation from the bank to each such negotiator. A sale of property upon credit to one, at another's request and upon his joint or secondary responsibility, is not a making of the seller's "credit available" to the buyer within this definition. See Trimble, *The Law Merchant and The Letter of Credit*, 61 HARV. L. REV. 981, 999 n. 70, 1003 n. 84, 1004 and n. 89 (1948); *Mechanics Bank v. N.Y., N.H. & H. R.R.*, 13 N.Y. 599, 629-30 (1856). A mere promise in writing to accept a bill of exchange is not a letter of credit. *Finkelstein, Acceptances and Promises to Accept*, 26 COL. L. REV. 684 (1926); see *Germania Nat. Bk. v. Taaks*, 101 N.Y. 442, 5 N.E. 76 (1886); *Banco Nacional Ultramarino v. First Nat. Bk.*, 289 Fed. 169, 173-4, 176 (D. Mass. 1923).

instrument in financing the domestic sales of motor vehicles. In that connection it usually provides for the drawing of sight drafts thereunder. In view of its lax use by a few banks in an over-extension or other abuse of credit, the Office of the Comptroller of the Currency has been considering the intrinsic power of National Banks to issue letters of credit and the limitations upon such power. In doing so the view has been expressed, in accordance with all of the leading authorities on the subject up to 1948, that National Banks acquired from the Federal Reserve Act their power to issue letters of credit which provide for acceptances, and that they, therefore, have no authority to issue letters of credit providing for acceptances of types other than those specifically described in the Federal Reserve Act. An essential of this reasoning is that prior to the enactment of that Act, National Banks had no power to accept time drafts. It has also been asserted that National Banks had no power to issue a *sight* letter of credit except against receipt of cash, in the amount of the letter, at the time of its issuance. The bank supervisory authorities in one or more of the states have raised similar issues as to the powers of state banks. Counsel for a number of National Banks and banking organizations have filed memoranda in support of the power of National Banks to continue to finance a great part of our international trade, and a substantial part of our domestic trade, through sight and time letters of credit.

In the consideration heretofore given to the principles governing the implied powers of National Banks, particularly as they relate to the issuance of letters of credit, one approach to the determination of the scope of the implied powers of National Banks has been largely overlooked in the decisions and by textwriters. The subject of the particular power of National Banks to issue letters of credit has presented a beautiful example of the universal tendency of men to accept as truth, and as a conclusion reached by reason, any proposition that has been sufficiently reiterated, especially when it has been reiterated by those learned in the field. With respect to that specific power, our leading authors on banking and banking law have stated that National Banks did not have lawful authority to issue letters of credit, providing for time acceptances, prior to the enactment of the Federal Reserve Act conferring that power upon them in December 1913.³ With respect to the broad question of the determination of the implied powers of

3. Neidle and Bishop, *Commercial Letters of Credit: Effect of Suspension of Issuing Bank*, 32 COL. L. REV. 1, 4 n. 8 (1932); FINKELSTEIN, *LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT* 5 n. 7 (1930); WHITAKER, *FOREIGN EXCHANGE* 134 n. 1 (1919); YORK, *INTERNATIONAL EXCHANGE* 298 (1923); WARD, *AMERICAN COMMERCIAL CREDITS* 15 (1st ed. 1922); see KNIFFEN, *COMMERCIAL BANKING* 778 (1923); WILLIS, *THE FEDERAL RESERVE SYSTEM* 981 (1923); WILLIS & STEINER, *FEDERAL RESERVE BANKING PRACTICE* 463 (1926); KEMMERER, *THE ABC OF THE FEDERAL RESERVE SYSTEM* 48 (9th ed. 1932); RUFENER, *MONEY AND BANKING IN THE UNITED STATES* 520 (1934); BURGESS,

National Banks, it has been frequently stated that the powers of National Banks are only the powers that are expressly conferred upon them by statute and those powers which, by necessity (in a broad sense), are incidental to such express powers.⁴

THE RESERVE BANKS AND THE MONEY MARKET 157 (rev. ed. 1936); REED, MONEY, CURRENCY AND BANKING 493 (1942).

Contra, WARD AND HARFIELD, BANK CREDITS AND ACCEPTANCES IN INTERNATIONAL AND DOMESTIC TRADE 88 (1948).

4. Another way of stating substantially the same narrow construction is that the implied powers of National Banks are confined to those powers which are incidental to the business of banking *as defined and limited by the express powers*. *Weckler v. First Nat. Bk.*, 42 Md. 581, 591-3 (1875). The opposing view is that National Banks have all implied powers incidental to carrying on the banking business and no such power need be incidental to any one of the express powers.

The narrower view apparently emanates from ambiguous statements by Mr. Justice Harlan in *Logan County National Bank v. Townsend*, 139 U.S. 67, 73-4 (1891). He stated: "It is undoubtedly true . . . that a national Bank cannot rightfully exercise any powers except those expressly granted by that act, or such incidental powers as are necessary to carry on the business of banking for which it was established." It is not clear from this whether he meant that the implied powers must be incidental to the express powers or to the business of banking, but later he states: "In the view we take of this case, it is unnecessary . . . to discuss the authorities cited to show that such a contract . . . is not embraced by any of the clauses of the statute specifying the different modes by which a national bank may carry on the business of banking" and thereby shows that he limited the implied powers to those powers which are incidental to the specifically expressed powers.

The first quoted passage from the *Logan County Bank* case was repeated by Mr. Justice White in *California (National) Bank v. Kennedy*, 167 U.S. 362, 366 (1897), apparently with the same meaning that implied powers must be incidental to the enumerated powers. Mr. Justice White used in a single paragraph two inconsistent statements. He first stated at p. 366: ". . . they cannot rightfully exercise any powers except those expressly granted, or which are incidental to carrying on the business for which they are established" (italics supplied), which would include powers not incidental to the specific powers. He followed with the inconsistent statement that: "The prohibition is implied from the failure to grant the power." The paragraph has been frequently cited. *First Nat. Bk. v. Converse*, 200 U.S. 425, 438-9 (1906); *Concord First Nat. Bk. v. Hawkins*, 174 U.S. 364, 367 (1899).

The *Logan County Bank* case was cited by Mr. Justice Sutherland, in *First National Bank v. Missouri*, 263 U.S. 640, 656 (1924), where he stated: "The extent of the powers of national banks is to be measured by the terms of the federal statutes relating to such associations, and they can rightfully exercise only such as are expressly granted or such incidental powers as are necessary to carry on the business for which they are established." It would appear that in this ambiguous sentence he used the term "incidental powers" to mean only such powers as are incidental to the express powers granted, and that a bank's implied powers do not include all such incidental powers but only those incidental to the enumerated powers which are also necessary to carry on the business of banking; for he later states at p. 659: "Certainly an incidental power can avail . . . only to carry into effect those which are granted." The term "granted" must mean "expressly granted" for otherwise this statement would be completely tautological; if the "granted" powers did not mean "expressly" granted, the "granted" powers would include all lawful incidental powers and there could be no additional incidental powers. *Cf. Texas & Pacific Ry. v. Pottorff*, 291 U.S. 245, 253-4 (1934). In *Awotin v. Atlas Exchange Bank*, 295

It is submitted that neither of these propositions is the law. While it may be conceded that the power to issue letters of credit is not incidental to any power expressly conferred upon National Banks by statute⁵ (or charter), it is submitted that National Banks have always had, and continue to have, implied power to issue letters of credit providing for payment of sight drafts and for the acceptance and payment of time drafts.

The direct acceptance of bills of exchange, and the issuance, against payment of cash or upon credit, of sight and time letters of credit, were incidents of the banking business carried on by the early British banks and other banks and bankers. By virtue of the provisions of the New York Banking Act of 1838,⁶ as interpreted by the New York Court of Appeals, New York banks possessed all powers necessary or appropriate to carry on such a banking business. It appears from the terms and legislative history of the National Bank Act of 1864,⁷ that National

U.S. 209, 211 (1935), Mr. Justice Stone expressed a similar, and again somewhat ambiguous, view: "Revised Statutes, § 5136, authorizes national banks to carry on a banking business and defines their powers."

The Court of Appeals, Seventh Circuit, in *Kimen v. Atlas Exchange Nat. Bk.*, 92 F.2d 615, 617 (7th Cir. 1937), *cert. denied*, 303 U.S. 650 (1937), while expressing conflicting concepts, clarified the meaning of these restrictive dicta. The court began upon the sound premise that: "National banks may rightfully exercise only such powers as are expressly granted and such as are necessarily incidental to the effectuation of their chartered purposes;" but then made its conflicting conclusion fairly clear. It stated: "Incidental powers can avail neither to create powers which expressly or by reasonable implications are withheld nor to enlarge the powers granted. They are inferred and exist only to carry into effect such powers as are granted," and held as to a repurchase agreement: "To our minds such agreements are no part of the express power of a national bank or in any way incidental to the effectuation thereof. Rather they seem to us wholly beyond any express or implied grant of powers by the Congress." (Italics supplied). See Note, 24 COL. L. REV. 633, 636 (1924): "Nor can the bankers' acceptance be saved by the clauses granting incidental powers, for these have been construed to mean powers incidental to those expressly enumerated . . ." citing *Seligman & Co. v. Charlottesville Nat. Bk.*, 21 Fed. Cas. 1036, 1039 (C.C. W.D. Va. 1879) where the court, in holding that a guaranty by a National Bank was *ultra vires*, expressed the dictum: "But the incidental powers given are not the incidental powers given generally to all banking institutions; but only such as are incidental to banks allowed to do such things as are prescribed by the statute. . . ." See also Wyatt, *Right of National Banks to Act as Transfer Agents*, 7 VA. L. REV. 594, 597-8 (1921). For cases *contra*, see *infra*, note 27.

A typical statement of this narrow interpretation with respect to state banks is that of the court in *O'Connor v. Bankers Trust Co.*, 159 Misc. 920, 933, 289 N.Y. Supp. 252, 270 (1936), *aff'd without opinion*, 278 N.Y. 649, 16 N.E.2d 302 (1938): "The question, therefore, is whether the agreement here claimed comes within the implied or incidental powers of the banks. Is the agreement incidental to the exercise of the express statutory powers?" See, also, *Farmers and Mechanics Bk. v. Baldwin*, 23 Minn. 198, 203 (1876); *Mathews v. Skinker*, 62 Mo. 329, 331 (1876).

5. See *Thilmany v. Iowa Paper Bag Co.*, 108 Iowa 333, 79 N.W. 68 (1899). *But see* WARD AND HARFIELD, *op. cit. supra* note 3, at 88.

6. N.Y. LAWS 1838, c. 260.

7. 13 STAT. 99 (1864).

Banks were granted all the powers of New York banks under the Act of 1838 as interpreted by the New York courts, except as they were specifically modified by the National Bank Act. These lawful powers are necessarily retained by National Banks except in so far as subsequent statutes may have eliminated or restricted them. Apart from any application of the statutory limitations upon the total obligations of a single obligor to a National Bank,⁸ and upon the amount of liabilities that may be incurred by a National Bank,⁹ subsequent statutes, with the possible exception of the Federal Reserve Act, have not restricted any powers of National Banks, under the National Bank Act, to accept bills, or issue letters of credit. The Federal Reserve Act (Section 13)¹⁰ limits the bills of exchange that a member bank (which term includes all National Banks) has authority to accept directly, possibly including acceptances drawn under its letters of credit, but it seems that it does not affect acceptances drawn against correspondent banks under letters of credit issued by member banks. It follows that it is not *ultra vires* for a National Bank to issue, upon credit or for cash, a sight letter of credit, or a time letter of credit providing for acceptances by it, which conform to the terms of Section 13 of the Federal Reserve Act; and, it seems, a National Bank may issue letters of credit providing for acceptances by correspondent foreign banks which do not conform with that Section.¹¹ These conclusions are sustained by a study of the law in detail.

THE NATIONAL BANK ACT OF 1864

Section 8 of the National Bank Act of 1864 provided that a National Bank might exercise:

“. . . all 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; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; by obtaining, issuing, and circulating notes according to the provisions of this act; . . .”¹²

From the time of the enactment of the original National Bank Act of 1864, there has been no express statutory authorization of any nature whatsoever for a National Bank to issue a letter of credit. The above quoted provisions have remained substantially unchanged and are con-

8. REV. STAT. § 5200 (1875), 12 U.S.C. § 84 (1946).

9. REV. STAT. § 5202 (1875), 12 U.S.C. § 82 (1946).

10. 38 STAT. 251 (1913), 12 U.S.C. § 221 (1946).

11. Reasoning which supports this conclusion is contained in the able article by Henry Harfield, *The National Bank Act and Foreign Trade Practices*, 61 HARV. L. REV. 782, 790-803 (1948).

12. 13 STAT. 99, 101 (1864).

tained in the first sentence of paragraph "Seventh" of Section 5136, United States Revised Statutes.¹³ These terms were derived from the Banking Law of New York.

As the court said in *Curtis v. Leavitt*,¹⁴ Chapter 260 of the Laws of the State of New York of 1838 inaugurated a new and improved system of banking in that state. Section 18 of that Chapter was as follows:

"§ 18. Such association shall have power to carry on the business of banking, by discounting bills, notes and other evidences of debt; by receiving deposits (sic); by buying and selling gold and silver bullion, foreign coins, and bills of exchange, in the manner specified in their articles of association for the purposes authorized by this act; by loaning money on real and personal security; and by exercising such incidental powers as shall be necessary to carry on such business; to choose one of their number as president of such association, and to appoint a cashier, and such other officers and agents as their business may require, and to remove such president, cashier, officers and agents at pleasure, and appoint others in their place."

This section remained unamended at the time of the enactment of the National Bank Act of 1864.

In 1857, the Court of Appeals of New York, in *Curtis v. Leavitt*, definitely settled the law of that state as to the implied powers of New York banks under the above quoted terms of the New York statute. It held that the powers of New York banks were limited only by the scope of the banking business, and that their implied powers were not confined to powers necessarily incident to those specifically listed in Section 18 of the Law of 1838.¹⁵ The court expressly rejected¹⁶ the view that the implied powers were so confined. This remains the law except in so far as relatively recent specific statutory enactments may have limited the powers of New York banks.¹⁷

13. 12 U.S.C. § 24 (1946). The only changes have been that a semi-colon has been inserted after the word "banking," the word "and" has been inserted preceding the words "by obtaining," and the word "act" has been changed to "title."

14. 15 N.Y. 9 (1857). The court reviewed (pp. 75-9) the history of the New York statute.

15. The decision clarified the dicta in *Talmadge v. Pell*, 7 N.Y. 328, 340, 343, 344 (1852) which, however, included the statement as to New York banks: "All these powers are incident to the express power to conduct the business of banking." *Id.* at 343.

16. 15 N.Y. 9, 262-71 (1857).

17. See *Nassau Bank v. Jones*, 95 N.Y. 115 (1884). In support of its holding, the court in the *Curtis* case referred to the nature of the banking business, which it held the New York banks were authorized to carry on, stating (p. 52) that: "Banking is not in its nature a corporate franchise. In the absence of legislative restraints, it may be carried on by individuals and partnerships in all its departments . . . ;" and in reference to the powers listed in Section 18 of the New York Law of 1838, the court concluded as to the authority conferred thereby (p. 54): "I know of no broader terms in the English language to define 'the business of banking' . . ." Similarly, Justice Brown, concurring on these

It seems clear that among the implied banking powers of New York banks was the power to accept bills. Mr. Justice Paige, in his concurring opinion in *Curtis v. Leavitt*,¹⁸ relied on the following citation as authority for such an implied power of New York banks:

"Best, J., in *Broughton v. Salford Water-Works* (3 Barn. & Ald. 1, 11), says: 'When a company like the Bank of England or East India Company are incorporated for the purposes of trade, it seems to result, from the very object of their being, that they should have power to accept bills . . .'"

Since under the decision of *Curtis v. Leavitt*, the New York banks had all powers incident to the banking business, and since the banking business (as practiced by British and other European banks for over 200 years) included the issuance of letters of credit and the acceptance of bills of exchange, the New York banks had legal authority to similarly issue letters of credit and accept bills.

The National Bank Act of 1864 was preceded by the Act enacted February 25, 1863 which first provided for a national banking system. Section 11 of the 1863 Act adopted verbatim (with two irrelevant changes) the powers set forth in Section 18 of the New York Banking Law.¹⁹ The National Bank Act of 1864 adopted, with only one relevant change, the terms of the 1863 Act, which in turn were substantially the terms of the New York statute of 1838. This change was the transposition of the clause: "such incidental powers as shall be necessary to carry on such business" from the end of the recital of powers in the 1863 Act (and the New York statute), to the beginning of such recital, and the consequent elimination of the original beginning clause: "power to carry on the business of banking."²⁰ It would appear that

points, said (p. 159) as to the power to borrow, which was not included in the express powers of the statute: "I am unable to see why borrowing, under such circumstances, is to be deemed an act *ultra vires* . . ." In 1827, a statement of principles similar to those reflected in the 1838 Act, had contained the following: "Banking is a free trade in so far that it may be freely entered into by individuals or associations under the provisions of a general statute." KNOX, HISTORY OF BANKING 94 (1st ed. 1900).

18. 15 N.Y. 9, 218 (1857).

19. It added to the power to carry on the business of banking, the words "by obtaining and issuing circulating notes in accordance with the provisions of this act" (a power provided elsewhere in the New York law); transferred the clause "in the manner specified in their articles of association, for the purposes authorized by this act," and added a provision as to the location of banking offices. In support of the bill which became the Act of 1863, it was explained that: "The bill in all its essential features is like the free banking law of the State of New York, which has been in successful operation in that State since 1838;" and that it was "a proposition to nationalize the banking system of the State of New York . . ." Congressman Baker stated: "I would like to see all the States of the Union adopt the free banking system of the State of New York in its present completeness and perfection." CONG. GLOBE, 37th Cong., 3rd Sess. 1114, 1142 (1863).

20. The terms of the New York statute were slightly ambiguous upon the point whether "incidental" powers were limited to those which were incidental to the specific

the transposition was made primarily to avoid redundancy by the elimination of one of the two clauses as to the "power to carry on the business of banking," and that it was not the intent of Congress thereby to make a major change in the existing powers of National Banks, namely, to take from them all their implied powers to carry on the business of banking which were not necessarily incidental to carrying out the specific powers, and which implied powers were granted to them by the 1863 Act.²¹

It follows that the National Bank Act of 1864 adopted in substance the terms conferring the banking powers contained in the New York Banking Act of 1838 and that Congress intended to confer upon National Banks all the powers of New York banks to carry on the banking business, except as such powers were clearly modified by the National Bank Act. Such an intention falls within the rule that when Congress enacts a statute in terms that have theretofore received a settled interpretation by the courts (or even by administrative rulings or practice) it in effect adopts that interpretation.²² Under that rule, National Banks organized under the National Bank Act have the same broad powers to carry on the banking business as the New York banks had under the decisions of the courts of that state prior to 1863.²³

powers, or included all those powers which were incidental to the business of banking. The ambiguity, however, was resolved by the holding of the New York courts that the incidental powers to carry on the business of banking were not limited to those incidental to the specific powers, and any continuation of ambiguity by the transposition of clauses in the National Bank Act of 1864 would seem immaterial. The other changes by the Act of 1864 were that it substituted the words "and negotiating promissory notes, drafts, bills of exchange," for the words "bills, notes," substituted the words "exchange, coin, and bullion" for "gold and silver bullion, foreign coins and bills of exchange," omitted the words "real and" (the limited powers to deal with real property being dealt with elsewhere in the Act—Sec. 28), and omitted the transferred clause quoted in note 19 *supra*.

21. That there was no such intention, seems clear from the First Annual Report of the Comptroller of the Currency, Nov. 28, 1863 (contained in the Report of the Sec. of the Treas., 1863, p. 49) which recommended the revision of the 1863 Act. It appears therefrom that National Banks were to retain substantially the powers of the New York Banks, (p. 54); *Inland Waterways Corp. v. Young*, 309 U.S. 517 (1940); *First Nat. Bk. v. Nat. Exch. Bank*, 92 U.S. 122 (1875). Moreover, ". . . repeals by implication are not favored," *U. S. v. Borden Co.*, 308 U.S. 188, 198 (1939). The amendment of the 1864 Act by the insertion of a semi-colon after the word "banking," see note 13 *supra*, is a slight indication that Congress has interpreted that Act as granting "all such incidental powers as shall be necessary to carry on the business of banking"—which is the first clause of the Act. It would appear that in chartering the First and the Second Bank of the United States, Congress contemplated that the banks would carry on the same banking business that individuals might conduct. See CLARKE AND HALL, *HISTORY OF THE BANK OF THE UNITED STATES* 738, (§ 7) 803-4, 807-8 (1832).

22. *Helvering v. Wilshire Oil Co.*, 308 U.S. 90, 100 (1939). The rule applies to the adoption of a statute from another jurisdiction. 2 SUTHERLAND, *STATUTORY CONSTRUCTION* § 5209 (3d ed. 1943).

23. It appears that due either to ignorance of the law to this effect, or to an archaic fear of corporate power, the current draft of a model state banking law, of the American

Therefore, whatever may be the legal rule as to business corporations, or municipal corporations,²⁴ it seems clear that National Banks are not confined to the powers specified in the National Bank Act and those necessary to carry out those specific powers;²⁵ and that in the case of National Banks, whatever might be the inclination of a bureaucratic mind in a bank supervisory authority to limit banking power, the test is not whether a power is necessarily incident to one of the specific powers granted, but whether it is properly implied from all the terms used, in the light of the general intent and purpose of the statute.²⁶ That a National Bank has all the implied powers necessary to carry on the banking business was the rule originally stated by the Supreme Court,²⁷ and it is unfortunate that it has been obscured by the

Bankers Association, omits any general grant of power to carry on the business of banking, such as that possessed by National Banks (and banks of those states which adopted the original free banking system of the State of New York), and confines the powers of banks incorporated under the suggested statute to the few specific powers severally granted thereby. See Section 20, and note, of the September 1948 *Tentative Draft Model State Banking Code* of the Special Committee of the American Bankers Association.

24. *Merrill v. Monticello*, 138 U.S. 673, 691-2 (1891).

25. *Bank of California v. City of Portland*, 157 Ore. 203, 69 P.2d 273 (1937).

26. Such a rule is similar to the rule for interpreting certain of the constitutional powers of the Federal Government—the full authority of Congress does not derive from an express grant alone but from “all the related powers conferred upon the Congress and appropriate to achieve ‘the great objects for which the government was framed.’” *Norman v. B. & O. R. Co.*, 294 U.S. 240, 303 (1935); cf. *Travis, An Epoch in the History of National Banking Associations*, 12 *IND. L. J.* 369 (1937): “. . . such associations enjoy only the statutory powers granted them and such incidental powers as may be necessary to carry out the intent and purpose for which the express powers are conferred.” In *Mercentile (Nat.) Bk. v. New York*, 121 U.S. 138, 154 (1887) the Court said with respect to the National Bank Act: “The key to the proper interpretation of the act of Congress is its policy and purpose.”

27. See *Aldrich v. Chemical National Bank*, 176 U.S. 618, 626, 627 (1900) where the Court said that a National Bank has the incidental power to borrow money in accordance with the usage of communities. There was considerable confusion as to the implied powers of corporations prior to 1863. See *Bank of Augusta v. Earle*, 13 Pet. 517, 519 n. 1, 587 (U.S. 1839); *Planters' Bank v. Sharp*, 6 How. 300, 322 (U.S. 1848). In its fear of the corporate form, one Court did not deny such an extreme statement as that an ordinary business corporation “is strictly limited to the exercise of those powers, which are specifically conferred on it.” *Beatty v. Knowler*, 4 Pet. 151, 167 (U.S. 1830). It seems clear, however, that in the first cases subsequent to the enactment of the National Bank Act of 1864, the Supreme Court recognized that National Banks had all the implied powers necessary to carry on the business of banking and were not limited to those which were incidental to their express powers.

In *Bullard v. National Eagle Bank*, 18 Wall. 589, 593 (U.S. 1873), the Court said merely: “The extent of the powers of National banking associations is to be measured by the act of Congress under which such associations are organized.” The case has been cited for the proposition that implied powers were limited to those incidental to the enumerated powers, but the Supreme Court made its contrary meaning clear two years later in *First Nat. Bk. v. Nat. Exchange Bk.*, 92 U.S. 122 (1875). In that case, counsel argued that every power not enumerated in Section 8 of the National Bank Act was as

language of that Court in a number of erroneous dicta since 1890.²³

The implied power of National Banks to issue letters of credit is derived from the practice of New York banks prior to 1863, as well as

much withheld as if it were in express terms prohibited, and that incidental powers must partake of the same character as the specifically granted powers and not enlarge them. However, the Court held with reference to the terms of Section 8: "Authority is thus given to transact such a banking business as is specified, and all incidental powers necessary to carry it on are granted. These powers are such as are required to meet all the legitimate demands of the authorized business, and to enable a bank to conduct its affairs, within the general scope of its charter, safely and prudently. This necessarily implies the right of a bank to incur liabilities in the regular course of its business, as well as to become the creditor of others . . . *Banks may do, in this behalf, whatever natural persons could do under like circumstances.*" *Id.* at 127. (Italics supplied). See *Third Nat. Bk. v. Boyd*, 44 Md. 47, 61 (1875): "Such a contract does not appear to be authorized by the terms of the 8th section [of the National Bank Act of 1864], as a transaction 'within the ordinary course and business of banking or incident to it' . . ." This statement clarified ambiguities in the opinion in *Weckler v. First Nat. Bk.*, 42 Md. 581, 593 (1875), in which the court correctly relied upon the New York law as determinative of the powers of National Banks, pointing out: "This 8th section is almost identical in terms (and as respects the present question, completely so) with the Banking Act of New York, of 1838, ch. 260 . . . ;" but erroneously relied upon that part of the dicta in *Talmadge v. Pell*, 7 N.Y. 328 (1852), to the effect that implied powers of New York banks were not those incident to the business of banking, but were those which were both incidental to the express powers and necessary to transact the business defined by the express powers, instead of citing and relying upon the later case of *Curtis v. Leavitt*, 15 N.Y. 9 (1857), to the contrary.

In *Baltimore & Ohio R.R. Co. v. Smith*, 56 F.2d 799, 801 (3d Cir. 1932), the court relied on the 1875 decision in *First Nat. Bk. v. Nat. Exch. Bk.*, 92 U.S. 122 (1875), and after quoting paragraph 7 of Rev. STAT. § 5136, stated: "Power is thus given to conduct a banking business and all incidental power necessary to carry it on . . ." *Accord*: *Colorado Bank v. Bedford*, 310 U.S. 41, 48 (1940); *Dunn v. McCoy*, 113 F.2d 587, 588-9 (3d Cir. 1940); *Williams v. Merchants' Nat. Bk.*, 42 F.2d 243, 247 (D. Minn. 1930); see *McCoy v. Adams*, 29 F. Supp. 815, 817 (E.D. Pa. 1939).

The above quoted passage from *First Nat. Bk. v. Nat. Exch. Bk.* was relied upon also in *State of Nebraska v. First Nat. Bk.*, 88 Fed. 947, 949 (C.C.D. Neb. 1898), and *Second Nat. Bk. v. U.S. Fidelity & G. Co.*, 266 Fed. 489, 493 (4th Cir. 1920), *appeal dismissed*, 254 U.S. 660 (1920). See *Clement Nat. Bk. v. Vermont*, 231 U.S. 120, 140 (1913); *Aldrich v. Chemical Nat. Bk.*, 176 U.S. 618 (1900). The rule is clear in *Western Nat. Bk. v. Armstrong*, 152 U.S. 346, 351 (1893) and *Auten v. United States Nat. Bk.*, 174 U.S. 125, 143 (1899). In the *Auten* case, the Court by its citation of *Curtis v. Leavitt* relied primarily upon the New York Law as interpreted in that case.

Any implication in *Texas & Pacific Ry. v. Pottorff*, 291 U.S. 245 (1934), that the powers of National Banks are only those expressly granted to them, was eliminated in *Inland Waterways Corp. v. Young*, 309 U.S. 517 (1940), where the prevailing opinion did not accept the view of three dissenting Justices (*id.* at 526) that the "powers are only those granted." Mr. Justice McReynolds, one of the dissenters, came right back within a month with a dictum (as distinguished from the holding in the *Inland Waterways Corp.* case) in *Yonkers v. Downey*, 309 U.S. 590, 596 (1940): "The measure of their powers is the statutory grant; and powers not conferred by Congress are denied."

In *Marion v. Sneed*, 291 U.S. 262, 269 (1934), decided the same day as the *Texas & Pacific Ry.* case, Mr. Justice Brandeis, who delivered the opinions in both cases, indicated the broader view in ruling against a claimed power: "The contention that such

from the interpretation of the New York statute by the New York courts. It is submitted that the rule that statutory enactment of the terms of a law previously interpreted adopts the interpretation, requires the adoption of an interpretation of the National Bank Act to accord with an established practice under the earlier New York statute, provided it was not in conflict with the interpretation of the New York statute by the New York courts. If it was the established practice under New York law, prior to and at the time of the enactment of the National Bank Act, for sight and time letters of credit to be issued as a necessary incident to carrying on the banking business, then the provisions of the National Bank Act must be interpreted as conferring authority upon National Banks to issue such letters of credit (inasmuch as such a practice would be in accord with the law as interpreted by the New York courts). The present power of National Banks to issue such letters of credit can thus be resolved as a mere question of fact—namely, the determination of the actual practices of banks under the New York law prior to 1863.²⁹

It appears that the practice of issuing letters of credit by banks and bankers, apparently including New York banks, existed prior to 1863.²⁹ This finds confirmation in the continuance of the practice, especially in large commercial ports such as New York City and after 1893, by the National Banks which were most active in financing foreign trade

power is generally necessary in the business of deposit banking has not been sustained."

The same view has been adopted by some of the state courts. In *First Nat. Bk. v. Ocean Nat. Bk.*, 60 N.Y. 278, 287, 288 (1875), the court stated as to the defendant national bank: "The powers of the corporate defendant are banking powers only, with such incidental powers as may be necessary to carry on the business of banking, with the privilege of buying and selling exchange, coin, and bullion . . . The statutory powers and franchise are entirely coincidental with the attributes of banking corporations as defined by the law merchant" (*cf. id.* at 294) Section 4 of the Federal Reserve Act (12 U.S.C. 24(1946)), which is substantially the same as the National Bank Act provision, has been similarly interpreted. *Fed. Res. Bk. v. Duffy*, 210 N.C. 598, 602, 188 S.E. 82, 84 (1936).

In *First Nat. Bk. v. Harris*, 108 Mass. 514, 516 (1871) the court stated: "Dealing in checks is also a part of the usual business of banking, and would be within the general powers of a bank, without special mention."

28. See note 4 *supra*.

29. *Cf. Inland Waterways Corp. v. Young*, 309 U.S. 517, 525 (1940): "Even constitutional power, when the text is doubtful, may be established by usage."

30. "Letters of credit have been known and used from ancient times on the continent of Europe and in England. In this country they have been used for a considerable period of time in foreign transactions, but they did not come into general domestic use until the outbreak of the war." [The First World War] Mead, *Documentary Letters of Credit*, 22 COL. L. REV. 297, 298 (1922); see STORY, *BILLS OF EXCHANGE* § 459 (4th ed. 1860), stating: "In respect to Letters of Credit, which are in common use in our commerce with foreign countries . . .;" ROELKER, *MANUAL FOR NOTARIES PUBLIC AND BANKERS* 43 *et seq.* (3rd ed. 1855); *Edmondston v. Drake*, 5 Pet. 624 (U.S. 1831); *Wildes v. Savage*, 29 Fed. Cas. 1226, No. 17,653 (C.C. D. Mass. 1839); *Baring v. Lyman*, 2 Fed. Cas. 794, No. 983 (C.C. D. Mass. 1841); GEORGE W. EDWARDS, *FOREIGN COMMERCIAL CREDITS* 65 (1922).

and travel. Many such letters provided for sight and time drafts payable in foreign currencies.³¹ Prior to 1914 export and import letters of credit provided more frequently for sight drafts than for acceptances by the issuer.³² The so-called "oriental letter of credit," in reality merely an "Authority to Purchase," provided for acceptances, usually with recourse to the drawer.³³ After the enactment of the Federal Reserve Act time letters of credit became more prevalent, but during World War II sight letters were used almost exclusively.

In regard to the practice of issuing letters of credit by National Banks in New York City, it is of some interest to note the remarks in 1922 (less than nine years after the enactment of the Federal Reserve Act) of a New York court, with respect to a witness:

"He was thoroughly qualified to testify, having been assistant cashier of the National Park Bank for 17 years, being familiar with letters of credit and issuing same as part of his duties and passing on the documents and drafts presented under such letters. He had issued an average of about 500 letters of credit a month, . . ." ³⁴

The reported cases also show that it was established and publicly

31. WARD, AMERICAN COMMERCIAL CREDITS 12-3 (1922); see 1 FED. RES. BULL. 269 (1915). The BANKERS DIRECTORY published semi-annually in Chicago by Rand McNally & Co. contains advertisements of 45 National Banks advertising their issuance of letters of credit prior to 1914. Such advertisements cover a period beginning with The First National Bank of Chicago in June 1876. If the banking business were not carried on with a secrecy, like that of a criminal enterprise, with respect to the general public, it would be public knowledge, or a fact readily ascertainable from bank records, that beginning prior to 1870 and up through 1913 National Banks in this country issued hundreds of letters of credit each year, including both commercial and travel letters, which prior to the end of the century were for the most part for drafts payable in pounds sterling, but many of which were for drafts payable in dollars. Not only was this true of National Banks in the large Eastern and Southern ports, but the records of a leading inland National Bank show letters of credit issued in the period to an aggregate value approaching \$100,000,000.

32. See FED. RES. BULL. 686 (1921). But it appears that until at least 1870, the power of National Banks to accept bills of exchange was never doubted. See *Merchants' Bk. v. State Bk.*, 10 Wall. 604, 647 (U. S. 1870): "All the authorities, both English and American, hold that a check *may be* accepted, though acceptance is not usual. . . . [citing] *Robson v. Bennett*, 2 Taunton, 395; *Grant on Banking*, 89; *Ch. on Bills*, 10 ed. 261; *Boyd v. Emmerson*, 2 Adolphus & Ellis, 184; *Kilsby v. Williams*, 5 Barnewell & Alderson, 816; *Story on Promissory Notes*, §§ 489, 490." *Meads v. Merchants' Bk.*, 25 N.Y. 143, 150 (1862). See, also, *Morse v. Massachusetts Nat. Bk.*, 17 Fed. Cas. 865, No. 9,857 (C.C. D. Mass. 1873).

Promises by National Banks to pay drafts were considered valid acceptances. See *Lindley v. First Nat. Bk.*, 76 Iowa 629, 41 N.W. 381 (1889); *State Bk. of Fox Lake v. Citizens' Nat. Bk.*, 114 Mo. App. 663, 90 S.W. 123 (1905). In 1882 acceptance of a check by a National Bank was held by the Attorney General to be a certification within the meaning of the statute forbidding certification except against deposited money. 17 ORS. ATT'Y GEN. 471 (1882).

33. FED. RES. BULL. 926 (1921).

34. *Vietor v. National City Bk.*, 200 App. Div. 557, 572, 193 N.Y. Supp. 868, 878 (1st Dep't 1922).

recognized normal banking practice, prior to 1863, for banks to issue letters of credit, travel and commercial, foreign and domestic.³⁵ It was based on banking procedure of bankers and merchants at least as far back as the ancient Greeks.³⁶

It thus appears that the New York banks interpreted their powers conferred by the New York law as permitting the practice, and a reenactment of the terms of that law would adopt the same interpretation. The enactment of the National Bank Act in substantially the terms of the New York Law not only adopted the interpretation of the New York courts in *Curtis v. Leavitt*, but also adopted the interpretation which appears to have been followed in the practices of the New York banks.

THE FEDERAL RESERVE ACT

The fifth paragraph of Section 13 of the original Federal Reserve Act, enacted December 23, 1913,³⁷ was as follows:

"Any member bank may accept drafts or bills of exchange drawn upon it and growing out of transactions involving the importation or exportation of goods having not more than six months sight to run; but no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half its paid-up capital stock and surplus."

By successive amendments, the paragraph has become the seventh paragraph of the Section and now provides:

[7. Acceptance of Drafts or Bills by member banks]

"Any member bank may accept drafts or bills of exchange drawn upon it having not more than six months sight to run, exclusive of days of grace, 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 shipping documents conveying or securing title are attached at the time of acceptance; or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples . . ." (The balance of the

35. *Baring v. Lyman*, 2 Fed. Cas. 794, No. 983 (C.C. D. Mass. 1841); *Wildes v. Savage*, 29 Fed. Cas. 1226, No. 17,653 (C.C. D. Mass. 1839).

36. Apparently credit was readily transferred or made available by a banker's letter under the highly developed banking system evolved by the Greeks in their city states and throughout the Mediterranean. EDMOND GUILLARD, *LES BANQUIERS ATHÉNIENS ET ROMAINS* 1-24 (1875) (copy in the Seligman Collection, Columbia Univ.). He places the beginnings of the banking business in the ancient cities of Asia Minor. *Id.* at 2. It is regrettable that his discussion of "la lettre de change" displays a scholar's typically loose legal reasoning. *Id.* at 9-10, 41-4. See, also, V. DE KOUTORGA, *ESSAI HISTORIQUE SUR LES TRAPÉZITES ET BANQUIERS D'ATHÈNES* (1859).

37. 38 STAT. 251 (1913), 12 U.S.C. § 221 (1946).

paragraph prescribes amended limitations upon the aggregate amounts of such acceptances).³⁸

These provisions expressly authorized the direct acceptance of drafts of strictly limited types. It would seem fairly apparent that such provisions were for the purpose not only of furnishing a self-liquidating security but also of assuring the credit standing, in the domestic market, of such member bank acceptances, and were not intended to affect letters of credit, except possibly those letters of credit which provide for acceptances by the issuing member bank. In providing by the Act for the creation of a new and elastic currency based in part upon commercial transactions, Congress envisioned the establishment of an acceptance market somewhat similar to that which existed in England.³⁹ The effort of Congress to establish a short-term investment of the highest quality was so successful that there is no recorded instance of a holder in due course having lost a single dollar of principal through United States bankers' acceptances. The Act made endorsed acceptances of the prescribed types eligible for discount by member banks with Federal Reserve Banks, and for purchase by the latter in the open market.

There is no evidence whatsoever that Congress intended to modify the established practice of member banks in issuing *sight* letters of credit. It is largely an unsupported assumption that Congress intended to prescribe limitations upon acceptances drawn under *time* letters of credit, even those drawn against, and for acceptance by, the issuing member bank (as distinguished from those drawn against the correspondent bank).

A statement by the New York Court of Appeals in *Atterbury v. Bank of Washington Heights* is not entirely irrelevant:

" . . . A trade acceptance is a form of obligation *revived* in this country in recent years under the regulations of the Federal Reserve Bank Board . . . a bankers' acceptance is a draft or bill of exchange of which the acceptor is a bank or banker engaged generally in the business of granting bankers' acceptance credits . . ." (Italics Supplied).⁴⁰

38. Paragraph 12 of Section 13 provides for acceptance by member banks of drafts drawn upon them by banks and bankers abroad "for the purpose of furnishing dollar exchange." This authorization is confined to those countries where such acceptances are required by the usages of trade. Both these types of acceptances by member banks are regulated by Regulation C of the Board of Governors of the Federal Reserve System.

39. 24 COL. L. REV. 633-5 (1924). *Rep. No. 69 of the Committee on Banking and Currency, H.R. 7837*, 63d Cong., 1st Sess. 11 (1913), which ultimately became the Federal Reserve Act, listed as a need of the banking system: "6. Creation of market for commercial paper"; namely, to open a market for bankers acceptances; SEN. REP. NO. 133, 63d Cong., 1st Sess. 26 (1913); WILLIS & STEINER, *op. cit. supra* note 3, at 463; WILLIS, *op. cit. supra* note 3, at 981.

40. 241 N.Y. 231, 239, 149 N.E. 841 (1925).

Even though Section 13 were interpreted as restricting all acceptances under letters of credit (both acceptances by the issuer and acceptances by the correspondent bank), there is no similar provision in the Federal Reserve Act that could be interpreted as restricting sight drafts. In fact, there is no mention in the Act of letters of credit of any kind, except that corporations organized under the Act of December 24, 1919, to engage in international or foreign banking operations, are expressly authorized, among many other specific powers, "to issue letters of credit."⁴¹ This provision of the 1919 statute is some indication that Congress deemed that National Banks had the power to issue letters of credit without specific statutory authority, inasmuch as it would appear that Congress did not contemplate any undue advantage to such corporations over National Banks in this respect (and also because Congress presumably knew of the established practice of National Banks in issuing letters of credit).

It is submitted that a proper interpretation of the statutes would be that there is but one limitation on the legal power of National Banks to issue sight letters. It is improper practice and unsound banking for a bank to issue a letter of credit which would make it possible for the bank's customer to become liable, on account of paid drafts for which the customer had not reimbursed the bank, in an amount greater than a single obligor is allowed to incur under Section 5200 of the Revised Statutes. This view is in accord with the ruling, of the Board of Governors of the Federal Reserve System and the Comptroller of the Currency in 1915, that the 10% limitation of Section 5200 did not apply to an acceptance when made, but only to the indebtedness arising upon maturity in case the drawer failed to furnish the funds for payment.⁴²

41. 41 STAT. 378 (1919), 12 U.S.C. § 615 (1946).

42. FED. RES. BULL. 269 (1915). This joint ruling further stated that a National Bank might lawfully issue a letter of credit providing for the making of it by acceptances over a period of more than six months (the maximum time specified, Federal Reserve Act § 13, for an accepted draft to run) provided no single acceptance thereunder exceeded that period.

The Board of Governors has also ruled that: "The limitations imposed by section 5200 of the Revised Statutes on the amount of money which may be borrowed by any individual from a member bank do not apply to acceptances of such bank, i.e., the customer procuring the acceptance has not borrowed money from the accepting bank but merely borrowed its credit. After maturity, however, the liability incurred is a liability within section 5200." FED. RES. BULL. 64 (1916); 197 (1918). In 1921 the Board ruled that "a member bank should not obligate itself to accept drafts under a letter of credit to such an amount that it is reasonable to anticipate that the aggregate amount of acceptances . . . outstanding" will exceed the limitation of Section 13 of the Federal Reserve Act. FED. RES. BULL. 816 (1921). Also it would be an unsound banking practice for a bank to issue letters of credit providing for the drawing of bills of exchange against itself or its correspondent banks in an excessive amount relative to its worth. The Attorney General of the United States, in an opinion to the Secretary of the Treasury, 27 OPS. ATT'Y GEN. 601 (1909), which considered an application of Section 5200, stated that it is a "question . . . of practical banking with respect to the means employed to minimize the chances of loans in excess of the

It may be noted that the amount of acceptances (other than acceptances of checks, *i.e.*, certifications) that a National Bank may have outstanding is governed by Section 13 of the Federal Reserve Act and not by Section 5200 of the Revised Statutes, respecting obligations of a single obligor, nor by Section 5202 of the Revised Statutes imposing limitations upon the amount of liabilities incurred by a National Bank.⁴³

In the light of the foregoing, it would seem that the provisions of Section 13 of the Federal Reserve Act did not *create*, by implication or otherwise, a power to issue letters of credit covering the acceptance of time drafts. It is clear that Section 13 has no relevancy at all to sight (*i.e.*, demand) drafts, or letters of credit providing for them.

Judge L. Hand stated in his dissenting opinion in *Pan-American Bank & Trust v. National City Bank*:

"I agree that paragraph 5 of section 13 of the Federal Reserve Act (Comp. St. § 9764) applies only to acceptances proper; that is, to acceptances payable on time, and not to sight drafts. The language seems to me clear, and the Reserve Board has so ruled.
 . . ."⁴⁴

Since National Banks had always had an implied power to issue letters of credit providing for acceptances of time drafts of any type (as well as letters of credit providing for the payment of sight drafts of any type), there is some ground for the view that the authorization in paragraph 7 of Section 13 of the Federal Reserve Act does not repeal that power in whole or in part, and that the only proper implication from the enactment of the (permissive)' authorization contained in paragraph 7 is a limitation upon the types of bills that a member bank is authorized to accept other than pursuant to a letter of credit issued

amount limited . . ." While the definition of "obligations" contained in Section 5200 is literally confined to those of endorsers, drawers or guarantors, and of the maker or acceptor of discounted or sold paper, it would seem that any loan would be held to be within the general intent of the section. Since the acceptance of a *check* has the legal effect of a certification, it creates a liability within the limitations of Section 5202 of the Revised Statutes. Since it is not a loan of money, but a loan of the credit of the bank, it is not within the limitations of Section 5200. 17 OPS. ATT'Y GEN. 471, 474 (1882). In New York a letter of credit has, by statute, been included as a lending "directly or indirectly" which is subject to the limitation upon lending to any single borrower. N. Y. BANKING LAW § 103.

43. FED. RES. BULL. 816 (1921); see Rule No. 49 of the Comptroller, CCH FED. BANKING LAW REP. ¶ 90,408 (1947); 17 OPS. ATT'Y GEN. 471 (1882).

44. 6 F.2d 762, 769 (2d Cir. 1925), *cert. denied*, 269 U.S. 554 (1925). Apparently Judge Hand referred to the present paragraph 7. The fact that paragraph 7 expressly applies to "member" banks, which include state banks, is some evidence that Congress did not consider it was creating a new power to accept drafts. It is obvious that Congress has no authority to create new corporate powers of banks incorporated under state law. *But see* FED. RES. BULL. 547, 816 (1921).

by it; in other words, that paragraph 7 does not affect in any way the power of National Banks to issue letters of credit providing for acceptances by them of types different from those specified in the paragraph.

As against such an interpretation of paragraph 7, there are a number of considerations. The authorization contained in the paragraph refers to acceptances of bills "which grow out of transactions involving the importation or exportation of goods." This describes the usual bills drawn under commercial letters of credit in international commerce. The legislative record indicates that at least some of the legislators thought that the authorization created a new power in National Banks,⁴⁵ so that to that extent there may be an implication that National Banks have no power to accept bills of other types than those specified. It is clear that Congress did intend to create in this country a type of bank acceptance of assured credit standing to be dealt in upon an acceptance market similar to that which existed in England. All these factors point to a Congressional intent that all acceptances by a National Bank, including those pursuant to its letter of credit, should conform to the types specified in paragraph 7. There is sufficient uncertainty as to the meaning of the statute so as to give an administrative body having jurisdiction of its administration some leeway in its interpretation. It would seem that such a body might properly rule that acceptances by a National Bank pursuant to its letter of credit must conform to the terms of paragraph 7, however unsound a policy it would be so to restrict commerce, and notwithstanding that the basic intent of Congress in enacting that paragraph was to enlarge the powers of member banks, not diminish them. It would seem rather clear that an administrative body could not properly rule that the bills accepted by a foreign correspondent bank, pursuant to a letter of credit issued by a National Bank, must conform with the terms of the paragraph.⁴⁶

45. See *Rep. No. 69 on H.R. 7837*, cited *supra* note 39, at 49, 52; 50 CONG. REC. 4798 (1913); 51 CONG. REC. 282 (1913); 51 CONG. REC. 1470 (1913). The idea that a new power was created (see citations *supra* note 3) would appear to have been derived from a single source—a misstatement, without reference to any authority, in a report of the National Monetary Commission. Jacobs, *Bank Acceptances*, SEN. DOC. NO. 569, 61st Cong., 2d Sess. (1910). At page 4 thereof, it is stated: "In the United States the national bank act does not permit banks to accept time bills drawn on them. Although the act does not specifically prohibit such acceptances, *the courts have decided that national banks have no power to make them.*" (Italics supplied). The assertion was quoted at page 49 of the House Report on *H. R. 7837*, cited *supra* note 39.

46. Following the enactment of the Federal Reserve Act a number of states enacted statutes expressly authorizing banks to accept bills and issue letters of credit. Section 106 of the Banking Law of New York was amended in 1914, (presently § 96), by adding provisions for New York State banks to become members of Federal Reserve Banks; by revising paragraph 1 of the section to more exactly conform to the first sentence of paragraph "Seventh" of Section 5136; and by expressly authorizing acceptances and letters of credit.

THE DECISIONS

Confusion as to the power of National Banks to issue letters of credit, has been created by the failure to distinguish between a true letter of credit and a guaranty.⁴⁷ The distinction is clearly stated in the case of *Border National Bank v. American National Bank*.⁴⁸

The distinction between an unlawful guaranty and a lawful direct obligation to pay (similar to that of the issuer of a letter of credit), is brought out in a ruling of the Board of Governors of the Federal Reserve System. An inland member bank may not give to its correspondent coastal bank a guaranty of the performance, by the customer of the inland bank, of his obligation to the correspondent bank for a letter of credit issued by the latter for the customer's account, but the inland bank may become primarily liable to the coastal bank for the advances made by the latter under the latter's letter of credit.⁴⁹

It seems clear from the decision in *Curtis v. Leavitt*, 15 N.Y. 9 (1857), and the banking business as carried on by New York and British banks, that this authorization was declaratory of the powers of New York banks. It no more created power to issue letters of credit than it created their power to accept drafts. See *First Nat. Bk. v. Ocean Nat. Bk.*, 60 N.Y. 278 (1875).

47. See dissent in *Bowen v. Needles Nat. Bk.*, 94 Fed. 925 (9th Cir. 1899), *cert. denied*, 176 U.S. 682 (1900); *Pan-American Bank v. National City Bank*, 6 F.2d 762, 766 (2d Cir. 1925), *cert. denied*, 269 U.S. 554 (1925); FINKELSTEIN, *op. cit. supra* note 3, at 19 n. 34; BIGELOW, *BILLS, NOTES AND CHECKS* § 54 n.1 (3d ed. 1928). Finkelstein states the law clearly when he says at 32-3: "A letter of credit . . . is not . . . a promise to pay if the buyer does not pay, a promise made collaterally to the buyer's obligation, as further security to the seller of the goods. The bank is neither a guarantor nor a surety, even though normally, as will be indicated presently, the buyer is not discharged by the issuance of a letter of credit but continues bound to the seller under the sales contract. The issuing bank has incurred a distinct, independent obligation contingent upon the performance of certain conditions contained in the letter of credit. The rules governing the obligations of sureties and guarantors have no application. . . ." Also *id.* at 33 n.22: "In this connection, it is immaterial whether the buyer pays cash for the opening of the credit or whether the credit is issued in reliance upon his undertaking to indemnify the bank, which may or may not require the deposit of collateral as additional security . . ."

48. 282 Fed. 73, 77 (5th Cir. 1922), *writ of error dismissed and cert. denied*, 260 U.S. 701, 732 (1922). The court stated: "A guaranty is a promise to answer for the payment of some debt, or the performance of some obligation, in the case of the default of another person, who is in the first instance liable for such payment or performance. A letter of credit confers authority upon the person to whom it is addressed to advance money or furnish goods on the credit of the writer . . . It is well settled that the guaranty of a national bank is ultra vires . . . But a national bank is bound by its letter of credit. *Decatur Bank v. St. Louis Bank*, 21 Wall. 294, 22 L. Ed. 560." The court pointed out the confusion which arises from the loose use of the word "guaranty" (*id.* at 77-8); followed in *Pan-American Bk. v. National City Bk.*, 6 F.2d 762, 766 (2d Cir. 1925), *cert. denied*, 269 U.S. 554 (1925); see FINKELSTEIN, *op. cit. supra* note 3, at 15 n.23, at 32-3; ZOLLMAN, *BANKS AND BANKING* §§ 5122, 5131 (1936). However the thoughtless confusion still continues. See *Dunn v. McCoy*, 113 F.2d 587 (3d Cir. 1940).

49. FED. RES. BULL. 547 (1921); cf. *Pan-American Bank v. National City Bank*, *supra* note 48.

In 1874, in the case of *Decatur Bank v. St. Louis Bank*,⁵⁰ cited in the opinion in the *Border National Bank* case, a letter of credit issued by a National Bank was enforced. In the trial court the defendant National Bank interposed a plea to raise the issue that National Banks were not authorized to issue letters of credit and that, therefore, the action could not be sustained upon the defendant's letter of credit. Issue to this plea was tendered by the plaintiff. Upon appeal, the attorney for the National Bank argued before the Supreme Court that National Banks did not have power to issue letters of credit inasmuch as such a power was not found among their express powers nor was it "incidental to any of the powers granted." The Court found that the letter was a letter of credit, stating:

"The basis of this suit is the letter of credit of 13th September, 1869."⁵¹

and gave judgment for the plaintiff. It fully enforced the letter of credit without in any way relying upon an estoppel, or the production of any evidence necessary to recovery upon an *ultra vires* contract. The Court stated, however:

"It was urged at the bar that National banks are not authorized to issue letters of credit, and if so, that the action cannot be sustained. But the record does not raise the question, and it cannot, therefore, be considered. It is true a plea was interposed which was doubtless meant to raise it, on which, issue to the country [sic] was tendered, but for aught that appears it was abandoned.

"No evidence was offered under it, but if this were not necessary the attention of the court at least should have been called to it, and proper instructions asked. If refused, error could have been assigned, and the point would then have been properly before the court for decision.

"Nothing of the kind was done, and it is too late to raise the question *now*."⁵²

The Court indicated that the type of business involved in the case was usually conducted on such letters of credit, for in referring to the reliance of the National Bank upon the security which was to accompany the drafts, the Court stated:

"Indeed, the business in which Frederick was engaged is usually conducted in this manner."⁵³

Inasmuch as it has been the general doctrine of the federal courts that an *ultra vires* contract is void, and inasmuch as the Court in the

50. 21 Wall. 294 (U.S. 1874).

51. *Id.* at 298

52. *Id.* at 302.

53. *Id.* at 299.

Decatur Bank case enforced the letter of credit on evidence which only sustained the enforcement of an *intra vires* obligation, it has been proper for the courts to consider the actual decision in that case to be authority for the proposition that a letter of credit is not *ultra vires* of a National Bank, even though the Court's reasoning on the point, expressed in its opinion, was upon a premise involving a mere point of pleading. Under the principle of *stare decisis*, such a decision standing alone would not have conclusive weight on the issue of *ultra vires*. However, the interpretation of the decision as an actual holding that the letter of credit was *intra vires*, is supported by the Supreme Court's refusal of a writ of error and certiorari in the *Border National Bank* case, where the decision in the *Decatur Bank* case was cited as establishing that proposition.⁵⁴ The proposition may thus be deemed to have been settled law at least since 1874.⁵⁵

Zollman, in Section 5122 of *Banks and Banking*, summarizes the law as follows:

"A national or state bank or trust company clearly has no power to guarantee contracts made by others. . . .

"However, the mere fact that a letter contains the word 'guaranty' or is limited in its operation to a particular article, such as a road grader, does not constitute it a guaranty such as would be *ultra vires* rather than a letter of credit *which is within the powers of the bank.*" (Italics supplied.)

In Section 5131 he points out that a letter of credit "is independent of the contract of sale between the buyer and the seller and is un-

54. FINKELSTEIN, *op. cit. supra* note 3, at 5 n.7, dismissed this case: "*Decatur Bank v. St. Louis Bank* is not in point, as the court expressly refused to consider the problem." This comment is without substance as it confuses the actual decision upon the evidence before the Court, with the reasoning expressed in the Court's opinion.

55. Other cases have sustained the issuance by National Banks of sight letters of credit. These are holdings that such issuance is within the inherent powers of such banks inasmuch as the Federal Reserve Act has no relevancy to the issuance of sight letters of credit. In *Second Nat. Bk. v. M. Samuel & Sons*, 12 F.2d 963 (2d Cir. 1926), the court held a general letter of credit, which provided for sight drafts and was issued by the Irving National Bank of New York City, a valid and enforceable contract regardless of whether or not there was any payment or benefit to the issuer, or any estoppel. The decision is clearly that the issuance was *intra vires*. It is significant that the letter of credit in that case, which was a "general" letter to any one acting upon it, had the high number: "No. 27439." In *Union Fruit Producers, Inc. v. Plumb*, 1 Wash.2d 278, 95 P.2d 1033 (1939), the court held as to a letter, in the nature of a letter of credit, issued by a National Bank, at 283: "The evidence in the case does not sustain appellant's second contention, that the contract was *ultra vires*." Similarly, in *Watson v. Jackson*, 264 S.W. 603 (Tex. Civ. App. 1924), *cert. denied*, 268 U.S. 699 (1925), a letter of credit issued by a National Bank, on credit, to honor sight drafts was enforced as an *intra vires* contract. The court held at 611: "The burden of proof was upon appellants to establish the plea of *ultra vires*, and we do not think they have discharged this burden;" *Nelson v. First Nat. Bk., of Chicago*, 48 Ill. 36 (1868).

affected by any breach of contract on the part of the seller or the buyer . . . ,” and states:

“Unlike the case of a guaranty, evidence of any such contract therefore is immaterial and inadmissible.”

THE MYTHOLOGY

The myths that grew up after the passage of the Federal Reserve Act are stated in one of Finkelstein's notes:

“It is the generally accepted opinion that, prior to the enactment of the Federal Reserve Act, national banks did not have the power to accept time drafts or to issue letters of credit. Whitaker, *Foreign Exchange* (1922) 134, n. 1; York, *International Exchange* (1923) 298 *et seq.*; Ward, *American Commercial Credits* (1922) c. I. However, since 1839 a few national banks had made use of foreign credits to finance our importations. Although the question was never directly passed upon in the Federal courts, that national banks did not have such authority is implied in several decisions. *Bowen v. Needles Nat. Bank*, 87 Fed. 430, 443 (C.C.S.D. Cal., 1898), *aff'd*, 94 Fed. 925 (C.C.A. 9th, 1899), *cert. den.* 176 U.S. 682, 20 Sup. Ct. 1024 (1900); *Merchants' Bank v. Baird*, 160 Fed. 642, 17 L.R.A. (N.S.) 526 (C.C.A. 8th, 1908); see *Thilmany v. Iowa Paper Bag Co.*, 108 Iowa 333, 79 N.W. 68 (1899), a decision by a state court to the effect that national banks could not issue letters of credit. See also *Commercial Nat. Bank v. Pirie*, 82 Fed. 799 (C.C.A. 8th, 1897). The general basis for this prohibition was the rule that banks could not lend their credit, 1 Morse, *Banks and Banking* (6th ed. 1928) § 65. Accordingly, as is indicated in several of the cases cited, a bank could probably issue letters of credit against cash or its equivalent, or undertake to honor drafts when put in funds by its depositor, see *First Nat. Bank v. Merchants' Nat. Bank*, 7 W. Va. 544 (1874). *Decatur Bank v. St. Louis Bank* is not in point, as the court expressly refused to consider the problem, 21 Wall. 294, 302, 22 L. Ed. 560, 562 (1874).”⁵⁶

Every one of the propositions in this quotation is either misleading or incorrect.

The first proposition, that National Banks did not have power to accept time drafts, is a paraphrase of the Whitaker citation for it. Recognizing the logic that, if a bank could not accept drafts, it could not issue letters of credit providing for such acceptances (and that it would have no greater power to issue sight letters of credit), Finkelstein added to Whitaker's statement that National Banks had no power to issue letters of credit. Whitaker states in the note which is cited: “It is the generally accepted opinion that prior to the enactment of the recent banking reform laws, *national* banks in the United States (or those

56. FINKELSTEIN, *LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT* 5 n.7 (1930).

chartered by the Federal government) did not have the legal power to submit to or accept time drafts." However, he adds in the same note: ". . . it may safely be said this mere legal disability of our leading class of banks had little or nothing to do with the failure up to that time of the acceptance business to develop in this country." The looseness of this language in its possible implication that if they had thought it advantageous, National Banks would have accepted time bills even though they had no legal power to do so, may be due to the fact that Mr. Whitaker was a professor of economics, and apparently not a professor of law or a practicing attorney. It seems that his basic fact was that for nonlegal reasons no substantial acceptance business had developed. His statement as to legal power to accept bills is, therefore, more or less gratuitous, and it is entirely unsupported.

Whitaker says nothing in his note concerning letters of credit. His preceding discussion,⁵⁷ however, indicates that all classes of American banks issued letters of credit before 1914. Moreover, the text to which the note applies is as follows:

" . . . In this instance we have an American bank providing for an American importation by authorizing a draft on itself payable in American dollars, while in the former case we had simply an English bank providing for an English importation by authorizing a draft on itself payable in English pounds. *But under ante-bellum conditions, and these were conditions that had persisted for a long period and had become normalized,* neither the banks in the United States nor those in most countries other than England did much business in credits permitting time drafts upon themselves. *Instead they issued in the great majority of cases what are called 'sterling credits.'* These comprise any credits under which the beneficiaries are empowered to draw drafts in pounds on English banks, whether the authorization issues from the English banks themselves or with their permission from banks in other countries. There are also similar and self-explanatory terms such as 'dollar credits,' 'franc credits,' and so on. *Before the war American banks were driving a large and ever-increasing traffic with our importers in commercial credits, as we call them,* but the vastly preponderating part of these were sterling credits. A few were franc or mark credits, while almost none were dollar credits. . . ."⁵⁸

"Mr. H. K. Brooks says in his 'Foreign Exchange Text-Book' (dated 1906) that 'probably ninety per cent of all letters of credit issued throughout the world are drawn in English money' (page 7). This signifies not that ninety per cent of the world's commerce is settled through London, but merely that ninety per cent of *the commercial and travelers' letters of credit* are for sterling. . . ."⁵⁹ (Italics supplied.)

57. WHITAKER, FOREIGN EXCHANGE 131-3 (1919).

58. *Id.* at 134.

59. *Id.* at 135-6.

Whitaker includes in his text, as a sample of a typical sterling letter of credit used for imports into the United States, a formal letter of credit issued by a National Bank at Chicago, dated July 1, 1913 (prior to the enactment of the Federal Reserve Act) and providing for drafts at sixty days sight on a London bank. The text⁶⁰ shows that the letter was issued on credit. It is clear, therefore, that Finkelstein's assertion of a lack of legal power to issue letters of credit is in conflict with the very authority upon which he primarily relies.

York, *International Exchange*, is the second citation for the first of Finkelstein's propositions. The book is on foreign exchange. It is stated, on the first page cited,⁶¹ referring to the First World War:

"Prior to the war the foreign trade of the United States was financed almost entirely by means of foreign currency bills, drawn either on the buyers, here or abroad, or *on overseas banks under commercial letters of credit*. . . ." (Italics supplied.)

In cases of drafts drawn on overseas *banks* under commercial letters of credit, indubitably most of those which covered imports into the United States were issued by American banks.⁶²

As to the acceptance of bills, York, who was Foreign Exchange Editor of the *Wall Street Journal*, states:

". . . Prior to the war American chartered banks lacked the legal authority to accept bills of exchange under commercial credits or otherwise, while the great international banking houses of the country, which labored under no such disability, did not make a practice of extending this manner of accommodation. This legal handicap so far as the national banks were concerned was removed by the passage of the Federal Reserve Act, which authorized them to accept bills drawn against them for commercial purposes, including those growing out of the exportation and importation of merchandise. The example of Congress was soon followed by a number of states, which granted a similar power to the banking institutions under their jurisdiction. . . ." ⁶³

This is an unsupported statement, which like Whitaker's would seem based more upon banking practice than upon legal power. In any event, in view of his earlier statement, to the effect that American banks issued letters of credit providing for acceptances by overseas banks, York must have thought that any lack of legal power to accept

60. *Id.* at 136, 147-50.

61. YORK, *INTERNATIONAL EXCHANGE* 298 (1923).

62. JACOBS, *op. cit. supra* note 3, at 12, stated the practice followed in 1910 and previously. He pointed out that the United States importer has "his bank arrange a credit with its London correspondent. He receives an undertaking, called a commercial letter of credit . . . On the strength of such a letter of credit, the shipper . . . is able to dispose of his bills on London and thus receive immediate payment for his goods."

63. YORK, *op. cit. supra* note 61, at 299.

a bill did not affect the power of a bank to issue a letter of credit providing for acceptances by a correspondent bank.

The last citation for Finkelstein's first proposition is Chapter I of Ward, *American Commercial Credits*. Although Mr. Ward is a member of the New York bar, he spoke from his practicing banker's experience following the enactment of the Federal Reserve Act.⁶⁴ In this first edition of his work, he stated, with respect to the period preceding 1914:

"Our national banks were not at that time permitted by law to accept time drafts. There was no obstacle to the acceptance of bills by private bankers, but the lack of anything approaching a discount market for these bills in New York was as effective as legal prohibition in keeping private bankers' acceptances from being created."⁶⁵

He pointed out, however, that:

"It was the lack of a discount market like that of London, Paris, or Berlin, which more than anything else made the acceptance of a New York bank useless as an instrument of finance. . . .

"The passage in 1913 of the Federal Reserve Act laid the basis upon which it was possible to develop in New York this sort of discount market that is indispensable to the creation of a center of international finance."⁶⁶

As to the power of National Banks to issue letters of credit before 1914, Ward records⁶⁷ the growth in the issuance of commercial letters of credit by such banks in New York City from 1893 to 1913.

It may be true that in 1913 it was the general idea of many, if not most, bankers that National Banks did not have the power to accept bills of exchange. However, the decisions of the courts and the history of the National Bank Act, seem never to have been considered by them. The idea would appear, therefore, to have stemmed from the strong antipathy of the American banker to that form of extension of credit. As stated by Ward,⁶⁸ the general practice of American banks was to rely upon promissory notes and their discount, instead of trade and bank acceptances.

The provincial attitude of American bankers is reflected in Mr. Paul M. Warburg's Foreword to the first edition of Ward's book. He there states:⁶⁹

"It is difficult for us to realize how radical the change in Ameri-

64. WARD, *AMERICAN COMMERCIAL CREDITS* 6 (1922).

65. *Id.* at 15.

66. *Id.* at 14-5.

67. *Id.* at 12-3.

68. *Id.* at 15.

69. *Id.* at iii-iv.

can banking psychology has been since the enactment of the Federal Reserve Act. When in 1914 the power to extend credits by the granting of bankers' acceptances was given to national banks, the majority of our leading bankers looked askance upon this new privilege, and some of them, indeed not the smallest amongst them, stated in no uncertain terms that as far as their bank was concerned it would never avail itself of this power. The result was that for the year 1914, open-market purchases by federal reserve banks was insignificant; by the end of 1915 it did not exceed \$65,000,000; and by the end of 1916 it had reached \$385,000,000, still a comparatively small figure for a country of the vast resources of ours.⁷⁰

"During all these years officials of the federal reserve system kept on preaching the gospel of bankers' acceptance credits, trying to persuade banks to do their part in supplanting foreign acceptance credits by those issued by our own banks. Real headway in this regard was made only in 1917 when the formation of large acceptance credit syndicates began to popularize acceptance banking amongst American banks. . . ."

It follows that Finkelstein's assertion, that prior to the enactment of the Federal Reserve Act National Banks did not have the power to issue letters of credit, is not only unsupported by the authorities he cites but is contrary to them. None of his citations raises the slightest doubt as to the power of National Banks, prior to 1913, to issue letters of credit which provided for sight and time drafts upon their foreign correspondent banks. His similar statement as to the power of American banks to accept drafts drawn upon themselves is a repetition of laymen's views, without any attempt at support by legal authority. In so far as it implies that National Banks had no power to issue letters of credit providing for acceptances of time bills by a correspondent bank, it is in conflict with the authorities he cites.

While the writers referred to by Finkelstein, in spite of the decisions and banking statutes, have doubted the authority of National Banks to make direct acceptances prior to 1913, and some members of Congress, at the time of the enactment of the Federal Reserve Act, accepted the view that National Banks had no such authority,⁷¹ no decision is cited by any of such writers, or in any of the records, which held that National Banks did not have power, prior to 1913, to issue letters of credit addressed to foreign banks, or other banks, providing for acceptances by such correspondent banks, and whereby the issuer did undertake to accept drafts drawn by the correspondent against the issuer in like amount.

Finkelstein is correct in stating that since 1839 some National Banks

70. The high of bank acceptances outstanding was over \$1,700,000,000. It was reached at the close of 1929.

71. See note 45 *supra*.

had made use of foreign credits to finance our importations, but he would have presented a clearer picture if he had stated that prior to 1894 the National Banks in New York City began issuing numerous commercial letters of credit to finance imports by drafts drawn on foreign correspondents under letters of credit.⁷² His statement that several decisions implied that National Banks did not have authority to issue such letters of credit is not borne out by his citations. Both the *Bowen* case and the *Merchants Bank* case dealt only with unlawful guaranties. No implication has been found in either, that National Banks had no power to issue a true letter of credit, commercial or travel. The *Thilmany* case is not (as asserted by Finkelstein) a *decision* that National Banks could not issue letters of credit; that conclusion was a mere dictum. The court in *Commercial National Bank v. Pirie* merely held that a *guaranty* by a National Bank "made for the sole benefit and advantage of others" was not binding, and said nothing as to letters of credit. On the other hand, in *Border National Bank v. American National Bank, supra*, a federal court in 1922 directly passed upon the question of the power of National Banks, prior to the enactment of the Federal Reserve Act, to issue letters of credit, to the extent at least that it cited the *Decatur Bank* case of 1874 as establishing the law to that effect. As pointed out above, the *Decatur Bank* case is in point on that proposition since the Court enforced a letter of credit issued by a National Bank on credit.

Since it is difficult to imagine any ground upon which a bank could not undertake any legitimate financial obligation that did not exceed an amount of cash paid to it therefor, it seems somewhat naive for Finkelstein to state that several cases "indicated" that "a bank could probably issue letters of credit against cash or its equivalent or undertake to honor drafts when put in funds by its depositor. . . ." ⁷³ He later indicates, however, that no distinction, as to the validity of letters

72. WARD, *op. cit. supra* note 64, at 12-3; see note 62 *supra*. There were, of course, no National Banks "since 1839," until the Act of 1863 (and no bank chartered by Act of Congress in that period). Some state banks used the word "national" in their names. DILLISTIN, *HISTORICAL DIRECTORY OF THE BANKS OF THE STATE OF NEW YORK* 54 (1946).

73. It appears that the court in the *Thilmany* case, (108 Iowa 333, 79 N.W. 68 (1899)), is the only court that has ever expressed the view that National Banks had no power to issue letters of credit prior to 1913 except when paid in cash, at the time of issuance, of the full amount of the bank's possible future liability thereunder. It was a dictum of a confused state court in Iowa fifty years ago, without the citation of any supporting authority. It has never been followed. It reflected the court's complete ignorance of the universal procedures for the carrying on of import and export trade. MEAD, *op. cit. supra* note 30, at 302, points out that: ". . . it is very seldom that the issuing bank has received from the buyer of the goods any funds in advance of the issuance of the credit." McCurdy states, as to an import acceptance letter of credit (35 HARV. L. REV. 553 (1922)): "Actual cash is practically never paid by the buyer for the letter of credit. Nor is a present loan arranged. The commission may, however, be paid in advance." If cash were deposited, there would be no need for a commercial letter of credit. See *Cutler v. Am. Exch. Nat.*

of credit, can be drawn between letters of credit issued for cash and those which are not.⁷⁴

The *First National Bank* case (entitled in the West Virginia reports, *Merchants National Bank v. First National Bank*), cited by Finkelstein as supporting the authority of a bank to accept when put in funds, involved the federal statute making it unlawful for a National Bank to certify checks except against funds on deposit with it, an entirely irrelevant subject.⁷⁵

No case in the United States has been found where a court has failed to enforce a sight or time letter of credit either on the ground that it was *ultra vires* or that it was issued without cash payment therefor and contemplated an extension of credit instead. The term "letter of credit" is here used in its accurate sense excluding guaranties.

If a letter of credit is considered an instrument of the Law Merchant, cash payment upon its issuance is no more relevant to its validity and enforceability than full cash consideration is relevant to a bill of exchange in the hands of a bona fide holder for value. Even if not considered an instrument governed by the Law Merchant, the issuance of letters of credit upon a credit basis has for centuries been a necessary incident to a fully developed banking business. Cash payment on issuance is, therefore, irrelevant upon the question of *ultra vires* with respect to a bank which has the express or implied "power to carry on the business of banking . . . by exercising such incidental powers as shall be necessary to carry on such business."⁷⁶ The power to issue a letter of credit upon a credit basis is historically as much an essential incident of the banking business as is the power to borrow money⁷⁷ and is similar to the power to draw a time bill of exchange.⁷⁸

The view that prior to the Federal Reserve Act the issuance of letters of credit by National Banks other than for cash was *ultra vires* is apparently based upon the erroneous conception that a letter of credit is a "lending of the bank's credit"⁷⁹ of the same nature as a guaranty by the bank of the performance of another's obligation. A guaranty, of course, is in ordinary circumstances *ultra vires* of any bank, and of most other corporations. The erroneous concept that cash payment is material to a letter of credit apparently arises from the law that some

Bk., 113 N.Y. 593, 21 N.E. 710 (1889), where the bank sent a letter advising of a special deposit, in the nature of a trust fund.

74. FINKELSTEIN, *op. cit. supra* note 56, at 32 n. 22, quoted note 47 *supra*.

75. A practice of using an acceptance, in lieu of a certification "good," apparently developed in attempts to avoid the original 1869 Statute. 15 STAT. 335 (1869); now covered by 12 U.S.C. 501 (1946). KNOX, *op. cit. supra* note 17, at 184-5.

76. N.Y. Laws 1838, c.260, § 18.

77. Cf. *Curtis v. Leavitt*, 15 N.Y. 9 (1857).

78. See *id.* at 167, 169, 222-5, 243, 260.

79. See 24 Col. L. Rev. 635-6 (1924).

bank guaranties, and other corporate guaranties, are *intra vires*, or at least sustain a recovery, when issued under circumstances which result, or may be reasonably expected to result, in a sufficient benefit to the issuing bank (or other issuing corporation).⁸⁰

As Finkelstein elsewhere says, with respect to an irrevocable export letter of credit:

"It is highly important to note that the bank has not in this case *guaranteed* or acted as surety for the performance of any act by the buyer. The bank has merely undertaken to perform a certain act, e.g., accept a draft upon the performance of certain conditions by the seller or beneficiary. *This distinction is legally of the utmost significance.* . . ." ⁸¹ (Italics supplied.)

There is no prohibition against the issuance of letters of credit on the ground that a bank cannot lend its credit,⁸² and the citation from Morse in the first quotation above from Finkelstein does not support his assertion that there is. Instead of supporting his statement, Section 65 of Morse does not contain any express or implied statement to the effect that National Banks lack the power to issue letters of credit on the ground that they are a lending of the bank's credit, or on any other ground. On the contrary, the Section expressly states:

"A national bank is bound by its letter of credit. . . .

"The rule of *ultra vires* as applied to a bank's guaranty, does not apply to its letter of credit."

CONCLUSION

Mr. Justice Field once used words which may be applied to the doctrine that National Banks had no power to accept drafts prior to 1913 and, more appropriately, to the doctrine that their implied powers are limited to those which are incidental to their express powers. He said:

"I admit that learned judges have fallen into the habit of repeating this doctrine. . . . And I confess that, moved and governed by the authority of the great names of those judges, I have, myself, in many instances, unhesitatingly and confidently, but I think now erroneously, repeated the same doctrine. But, notwithstanding the great names which may be cited in favor of the doctrine, and notwithstanding the frequency with which the doctrine has been

80. See *Bowen v. Needles Nat. Bk.*, 94 Fed. 925 (9th Cir. 1899), *cert. denied*, 176 U.S. 682 (1900).

81. FINKELSTEIN, *op. cit. supra* note 56, at 15 n. 23.

82. Cf. *Federal Intermediate Credit Bk. v. L'Herisson*, 33 F.2d 841, 847 (8th Cir. 1929).

reiterated, there stands, as a perpetual protest against its repetition, the Constitution of the United States. . . ."⁸³

For present purposes, the phrase "the established rules of law" can be substituted for "the Constitution of the United States." It may be hoped that as our civilization becomes one based more on reason and less on historical accident, this frank recognition of past error will attain classic status.

Ward and Harfield, in the latest edition of Ward's book,⁸⁴ completely disagree with the old mythology. They recognize that National Banks have inherent power to issue letters of credit providing for sight drafts and acceptances and that such power was not created by the Federal Reserve Act. Citing Finkelstein's note 7 quoted above, they state:⁸⁵ "Most textbook writers seem to be of the view that prior to the enactment of the Federal Reserve Act in 1913 national banks did not have power to accept time drafts nor to issue letters of credit." They follow this with their own present conclusion: "Actually the power to issue letters of credit is inherent in the general banking power to deal in credit." They accept Professor Llewellyn's opinion:⁸⁶ "In result, I find no aspect or probably [sic] credit practice whose availability to national banks depends, as a question of power, on the Federal Reserve Act. That power derives instead from the nature of the business of banking." They add: "By whatever means the result has been obtained, it now seems clear that no question can properly be raised as to the inherent power of banks to issue letters of credit of any character and upon any terms, subject only to express limitations in the charters of the banks or to express statutory or administrative restrictions which are based upon the soundness of the practice and not upon the underlying power."⁸⁷

83. Dissenting opinion, *Baltimore & Ohio R.R. v. Baugh*, 149 U.S. 368, 401 (1893). Mr. Justice Brandeis admired this passage and used it in *Eric Railroad Co. v. Tompkins*, 304 U.S. 64, 78 (1938).

84. WARD AND HARFIELD, *op. cit. supra* note 3.

85. *Id.* at 88.

86. *Id.* at 72.

87. *Id.* at 73-4.

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