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Banks and Banking--Notes Discounted by Non-Banking Corporation in Violation of Banking Law Section 131 and General Corporation Law Section 18 Held Void (Miller v. Discount Factors, Inc. 1 N.Y.2d 275 (1956))

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case, where by operation of the statute, the survivor was entitled to the money in the accounts.[14] The majority, however, held the form of the account was not controlling and resorted to the *Clary v. Fitzgerald* formula of weighing extrinsic evidence to determine whether the decedent had, in effect, intended to create a joint tenancy. The reasoning of the Court in support of this conclusion is none too clear. It appears that the fact that the decedent was suffering from a fatal illness, coupled with the fact that her actual intention was to convey powers of attorney, permitted, in the mind of the majority, the inference that the decedent was incompetent; and, therefore, the instrument was not knowingly and consciously drawn. Under the circumstances, incompetency could have two possible implications: (1) that there was a lack of rational capacity, of which there was no evidence, or (2) that there was a lack of knowledge of the full legal implications of the instrument signed. Here the law charges a person with the legal consequences of the instrument signed, regardless of the lack of such knowledge.[15]

Such a conclusion as was reached in the present case has destroyed the conclusive effect of the statutory presumption and can only lead to an uncertainty in the law which the Legislature had attempted to erase with this conclusive provision.[16] It would seem that the Court could have given effect to the intention of the decedent by the imposition of a trust on the accounts, and thus avoided doing violence to the act of the Legislature.

BANKS AND BANKING—NOTES DISCOUNTED BY NON-BANKING CORPORATION IN VIOLATION OF BANKING LAW SECTION 131 AND GENERAL CORPORATION LAW SECTION 18 HELD VOID.—Plaintiff, an accommodation indorser of five promissory notes made to secure a loan by defendant Discount Factors to the maker, sues to recover on three notes alleging that they are invalid and that he made payment under a mistake of law. The notes had no legal inception prior to

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[14] ". . . [T]he simple fact is that we are here concerned . . . with a document creating a joint bank account. This, the legislature has said in the plainest of language, conclusively effects a right in the survivor, absent evidence of incapacity, fraud or undue influence, to the balance in the account upon the other's death." Matter of Creekmore, 1 N.Y.2d 284, 299-300, 135 N.E.2d 193, 201 (1956).

[15] Knight v. Kitchin, 237 App. Div. 506, 511, 261 N.Y. Supp. 809, 815 (4th Dep't 1933) (dictum).

[16] In 1950, upon recommendation of the Law Revision Commission, a bill excising the presumptive evidence clause from section 239(3) was submitted to Judiciary Committee of the Legislature, but was never reported out of committee. See REPORT, N.Y. LAW REVISION COMMISSION 515, 567 (1950).

their negotiation to Discount who deducted in advance the larger part of its compensation in the form of a "bonus charge." A holder from Discount sued the plaintiff upon the remaining two notes. The two actions were consolidated. *Held:* the notes were void under Section 131 of the New York Banking Law, and no action could be maintained thereon. Since the jury found plaintiff-indorser paid with knowledge of his rights, he could not recover. *Miller v. Discount Factors, Inc.*, 1 N.Y.2d 275, 135 N.E.2d 33 (1956).

Section 131 of the Banking Law [1] and Section 18 of the General Corporation Law [2] form part of a series of acts commencing in 1804 [3] and commonly known as the "Restraining Acts." [4] They were enacted to protect the monopoly of chartered banks [5] and to protect the public against currency inflation by unauthorized banking.[6] The policy of monopolistic banking was abandoned in 1837,[7] and in 1838 a general statute for incorporation of banks was adopted.[8] The two above named statutes, however, continue the restraint upon the exercise of banking functions by limiting the practice of discounting to banking corporations.[9]

Whether these statutes prohibit corporations from making discounts when they exercise no other banking functions or merely when they make discounts in conjunction with other banking activities is a

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[1] "Prohibitions against encroachments upon certain powers of banks and trust companies.

"1. . . . . No corporation, domestic or foreign, other than a national bank or a federal reserve bank, unless expressly authorized by the laws of this state, shall employ any part of its property, or be in any way interested in any fund which shall be employed for the purpose of receiving deposits, making discounts . . . . All notes and other securities for the payment of any money or the delivery of any property, made or given to any such association, institution or company, or made or given to secure the payment of any money loaned or discounted by any corporation or its officers, contrary to the provisions of this section shall be void." N.Y. BANKING LAW § 131.

[2] "Prohibition of banking powers.

"No corporation, domestic or foreign, other than a corporation formed under or subject to the banking laws of this state or of the United States, and except as therein provided shall by any implication or construction be deemed to possess the power of carrying on the business of discounting bills, notes or other evidences of debt. . . ." N.Y. GEN. CORP. LAW § 18.

[3] Laws of N.Y. 1804, c. 117; extended by Laws of N.Y. 1818, c. 236.

[4] Note, 5 ST. JOHN'S L. REV. 234, 237 (1931).

[5] See N.Y. Firemen Ins. Co. v. Ely, 2 Cow. 678, 711 (N.Y. 1824); Kupfer, *Prohibited Discounts Under the Banking and General Corporation Laws*, 12 RECORD 30, 33 (1957).

[6] See Curtis v. Leavitt, 15 N.Y. 9, 69 (1857). See also the reference to Governor Clinton's Message to the Legislature in 1 CONSOL. LAWS OF N.Y. 297 (Birdseye, Cumming & Gilbert, 1st ed. 1909).

[7] Laws of N.Y. 1837, c. 20. See Curtis v. Leavitt, 15 N.Y. 9, 77 (1857).

[8] Laws of N.Y. 1838, c. 260.

[9] N.Y. BANKING LAW § 131; N.Y. GEN. CORP. LAW § 18.

current problem.[10] Some early cases arose under the "Restraining Acts" which lend support to the proposition that discounting is prohibited to a non-banking corporation under *all* circumstances.[11] In two later cases, notes discounted in violation of the "Restraining Acts" were held void.[12] Both cases, however, involved corporations doing a full banking business when they had been granted only limited banking powers.[13]

Then came *Meserole Securities Company v. Cosman* [14] which laid the foundation for the decision in the instant case. *Meserole* involved the purchase by a non-banking corporation of certain existing notes at less than face value from a holder thereof, not from the maker.[15] The corporation engaged in numerous similar transactions, but otherwise exercised no banking powers.[16] In upholding the validity of the notes the Court recognized that not every exercise of a power which banks possess constitutes a banking business.[17] Powers conferred upon banks may be ordinary business powers when exercised in a commercial transaction.[18]

> The Legislature has, of course, not attempted to forbid business corporations from exercising any of these powers occasionally and incidentally to a commercial business, but it has provided that no corporation shall by any implication or construction be deemed to possess the power to *carry on a business* which constitutes a *form* of banking business. . . .[19]

The Court, however, chose to rest its decision upon a second ground, holding that a corporation is not prohibited from purchasing notes which had a valid inception at a discount "where such purchase is not a mere device for carrying on the business of advancing or loaning money at interest." [20] The distinction between notes discounted when a *loan* is made, and the *purchase* of existing notes at a discount, has been upheld in subsequent cases.[21]

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[10] Kripke, *Illegal "Discounts" By Non-Banking Corporations in New York*, 56 COLUM. L. REV. 1183, 1188 (1956).

[11] See People v. Bartow, 6 Cow. 290 (N.Y. 1826); National Bank of Phoenix v. Warehousing Co., 6 Hun 71 (N.Y. Sup. Ct. 1875). *But see* People v. Brewster, 4 Wend. 498 (N.Y. 1830).

[12] Pratt v. Short, 79 N.Y. 437 (1880); New York State Loan and Trust Co. v. Helmer, 77 N.Y. 64 (1879).

[13] *Ibid.*

[14] 253 N.Y. 130, 170 N.E. 519 (1930).

[15] Meserole Securities Co. v. Cosman, 253 N.Y. 130, 170 N.E. 519 (1930).

[16] *Ibid.*

[17] *Ibid.*

[18] *Ibid.*

[19] *Id.* at 134, 170 N.E. at 520.

[20] *Id.* at 147, 170 N.E. at 525. *But see* Atlantic State Bank v. Savery, 82 N.Y. 291 (1880).

[21] See Siebros Finance Corp. v. 190 West Fourth St. Realty Corp., 256 N.Y. 586, 177 N.E. 151 (1931) (mem. opinion) (purchase); Pennsylvania Factors Corp. v. S. Oldman, Inc., 272 App. Div. 1049, 74 N.Y.S.2d 670 (1st Dep't 1947) (per curiam) (purchase); Yorkville Business Protective Corp. v.

In the instant case the defendant, Discount Factors, a corporation organized under the Stock Corporation Law and authorized under its charter to lend money, was in the business of lending money to merchants and taking back their notes or buying their paper.[22] The face value of the notes under consideration totaled $15,000 with interest at 6% per year. Discount Factors acquired them for $13,825 deducting a $675 bonus and $500 for the note broker. The effective interest rate was thus 24% per year or more than the 6% discount rate allowable to banks.[23]

The appellate division unanimously held that the transaction did not violate the statutory prohibition against discounting.[24] The court interpreted the "Restraining Acts" as limited to a prohibition of encroachments on banking powers. Since the loan here was beyond that possible by a bank and since there was no deduction of interest in advance, no violation had occurred.[25]

The Court of Appeals, however, in a five-two decision, relied upon the second ground of the *Meserole* decision. Since the notes had not had a valid prior inception in a transaction between the borrower and payee, the case was on the opposite side of the purchase-loan distinction drawn in *Meserole* and the invalidity of the notes could thus be established.[26] The fact that only "bonus charges" and not interest had been deducted in advance did not alter the effect of the transaction. The Court said "the word 'discount' has been interpreted to mean a charge for a loan in advance, whether called interest, compensation or premium." [27] Section 131 of the Banking Law and Section 18 of the General Corporation Law were interpreted by the Court as prohibiting corporations from discounting notes even when unaccompanied by any other banking operations. "The prohibitions . . . are phrased in the *disjunctive,* and no corporation may be deemed to possess the *power* to discount notes *or* do any other acts prohibited by said statutes." [28]

Friedman, 144 Misc. 325, 258 N.Y. Supp. 689 (App. T. 1st Dep't 1932) (per curiam) (loan); Proper Spirit Trading Corp. v. Schilowitz, 140 Misc. 171, 250 N.Y. Supp. 118 (App. T. 1st Dep't 1931) (loan).

[22] Miller v. Discount Factors, Inc., 1 N.Y.2d 275, 135 N.E.2d 33 (1956), *reversing* 285 App. Div. 772, 141 N.Y.S.2d 140 (1st Dep't 1955).

[23] N.Y. BANKING LAW § 108.

[24] Miller v. Discount Factors, Inc., 285 App. Div. 772, 141 N.Y.S.2d 140 (1st Dep't 1955).

[25] *Ibid.*

[26] Miller v. Discount Factors, Inc., 1 N.Y.2d 275, 135 N.E.2d 33 (1956). In Sabine v. Paine, 223 N.Y. 401, 119 N.E. 849 (1918), the defendant made a note payable to her agent who had it discounted for her by the plaintiff at a usurious rate. Although the plaintiff did not know that the note had had no prior legal inception, and that he was loaning money upon it, the Court found that a loan had been made when plaintiff discounted the note.

[27] Miller v. Discount Factors, Inc., 1 N.Y.2d 275, 281, 135 N.E.2d 33, 37 (1956).

[28] *Id.* at 282, 135 N.E. 33, 38.

As the judicial interpretation of the restraining statutes has thus evolved, if a borrower gives his note for $1,000 to a non-banking corporate lender who supplies him with $940 cash, there has been an illegal discount and the note is void. If the borrower instead makes his note for $1,000 with interest at 6% and receives $1,000 in cash from the lender, no discount being involved, the note is valid.

Although these two cases are clear cut, the line of distinction is not nearly as apparent in other instances. Suppose the lender were to ask for two notes, one for $1,000 representing the amount of the loan and a separate note for the $60 charge. If the note for the principal and the note for interest cannot be separated and the entire transaction involves an illegal discount, what is the status of corporate bonds with interest coupons attached if purchased by corporate underwriters? [29]

The statutes under consideration are an example of the special protection generally afforded to banks in the area of lending.[30] The instant case points out the need for a critical re-examination of the "Restraining Acts" in the light of present day economic and commercial activities. Lending by a non-banking corporation does not create a deposit and have the indirect effects on the economy which monetary regulation is designed to control.[31] Therefore, a more modified restriction of lending and discounting by non-banking corporations may be sufficient.

INSURANCE—CO-OPERATION CLAUSE—VERIFICATION OF THIRD-PARTY COMPLAINT.—Plaintiff-insurer brought this action to have a policy declared forfeit. The mother of defendant-insured was the driver of his car in an accident wherein defendant's father was killed. Defendant's mother, as executrix, then sued defendant for wrongful death for his imputed negligence.[1] Plaintiff undertook to defend insured, but insured refused to verify a cross-complaint against his mother. The Court *held* that the co-operation clause binding defendant to ". . . assist . . . in the conduct of suits," did not obligate

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[29] See Kripke, *Illegal "Discounts" By Non-Banking Corporations in New York*, 56 COLUM. L. REV. 1183, 1192-93 (1956).

[30] Although a usurious instrument is void and no action may be maintained thereon (N.Y. GEN. BUS. LAW § 373) a bank may recover the principal of a note (N.Y. BANKING LAW § 108). See Schlesinger v. Gilhooly, 189 N.Y. 1, 81 N.E. 619 (1907).

[31] Kripke, *supra* note 29, at 1196; Kupfer, *Prohibited Discounts Under the Banking and General Corporation Laws*, 12 RECORD 30, 45-46 (1957).

[1] N.Y. VEHICLE & TRAFFIC LAW § 59.