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Corporations and Accommodation Paper

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NOTES AND COMMENT

CORPORATIONS AND ACCOMMODATION PAPER.

The first sentence of Section 55 of the Negotiable Instruments Law reads as follows: "An accommodation party is one who has signed the instrument as maker, drawer, acceptor or indorser, without receiving value therefor, and for the purpose of lending his name to some other person." In the past, the ambiguous wording of this sentence has caused much conflict and confusion as to the meaning of "an accommodation party". The long overdue Morrison's Pill was supplied recently by a judicial interpretation of this sentence which fixed the word, "instrument", as the logical antecedent of the phrase, "without receiving value therefor". It follows, therefore, that an accommodation party is one who receives no consideration for a negotiable instrument which he has signed with the intention of lending his credit to another party. Consequently, the fact that an accommodation party receives consideration for signing the instrument does not change the status of such party. Such change of status occurs only when the supposed accommodation party receives value for the instrument.


3 Carr v. Wainright, 43 F. (2d) 507 (C. C. A. 3d, 1930); see 1 DANIEL, NEGOTIABLE INSTRUMENTS (7th ed. 1933) 216, where it is said that, ** the term 'value' relates to value for the instrument, and not to the loan of the name by way of accommodation."

4 Cf. 1 DANIEL, loc. cit. supra note 3; 1 POPE, LEGAL DEFINITIONS (1919) 11; 1 WORDS & PHRASES (4th series) 45; BREWSTER, op. cit. supra note 1, at 32 (accommodation paper is paper without consideration).

5 Where after corporation gave two notes on purchase price of land to vendor, payee believing that, if president of corporation would indorse notes and make himself personally liable for their payment, payee could negotiate the notes, agreed to pay president $1,667 for his indorsements by crediting said amount on one of the notes. The payee was thereafter unable to sell notes and sued president on his indorsement, but was not entitled to recover because president was the accommodation indorser, and payee was the accommodated party. Carr v. Wainright, 43 F. (2d) 507 (C. C. A. 3d, 1930); Nat. Park Bank v. German-American etc. Co., 116 N. Y. 281, 22 N. E. 567 (1889); Bacon v. Montauk Brewing Co., 130 App. Div. 737, 115 N. Y. Supp. 617 (1st Dept. 1909); McGhee Inv. Co. v. Kushner, 71 Colo. 137, 204 Pac. 891 (1922); Cook v. American Tubing & Webbing Co., 28 R. I. 41, 65 Atl. 641 (1905).

6 In an action against a corporation as an indorser of a promissory note the defense that the corporation was an accommodation indorser and that plaintiff was aware of that fact was not available, in view of the fact that the con-

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These principles are applicable to both corporate and individual accommodation parties. Therefore, an appreciation and a strict application of these principles will necessarily make for a better understanding of the nature of the authority and liability of a corporation in regard to accommodation paper.

I.

A consideration of the extent of a corporation's authority to act as an accommodation party reveals three types of corporate accommodation paper:

1. Where a corporation extends its credit to another corporation or individual by executing, accepting or indorsing a negotiable instrument gratuitously, such corporation is a party to gratuitous accommodation paper.

2. A more common type of corporate accommodation paper can best be described as non-gratuitous. This type of paper is characterized by the receipt of some consideration or security by the corporation for the loan of its name.

3. Another type of corporate accommodation paper results from those transactions whereby the corporation may or will receive, for the instrument itself, a benefit, which is so remote as to leave unaffected the corporation’s status as defined by Section 55 of the Negotiable Instruments Law.

It is seldom that a corporation possesses express authority to act as a gratuitous accommodation party. And in view of the courts'
traditional reluctance to imply such extraordinary authority, only the broadest charter terms will move the courts to recognize inferentially the existence of such right. The rule is well settled that the courts will not imply authority to act as a gratuitous accommodator merely from a general right to issue and indorse negotiable paper. The reasons for the courts' antipathy against obligations of this kind are: first, gratuitous accommodation paper is based on no consideration and, therefore, the issuance, acceptance or indorsement of such paper would amount to a gift of the corporate funds; secondly, the corporate funds can be used only for those purposes expressly or impliedly provided for in the charter, and in the absence of such authorization, a gratuitous accommodation would amount to a fraud upon the stockholders who are the ultimate owners of the corporate funds; and thirdly, the rights of the creditors of the corporation would be similarly prejudiced by such transactions which obviously are not within the prescribed scope of its business.

Whether implied authority to become an accommodation obligor exists where the corporation possesses an express right to become surety or guarantor is not certain. However, there is some indication

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9 A corporation was held to have the right to become an accommodation indorser where it was chartered to engage in a general brokerage and financial business, and authorized to engage in any business transaction commonly carried by capitalists, promoters and financiers; to indorse promissory notes and other commercial paper; to assist financially or otherwise corporations, individuals and others, and give any guaranty in connection therewith for the payment of money; to lend money or credit to, and aid in any other manner, any person or corporation. Bennett v. Corporation Finance Co., 258 Mass. 306, 154 N. E. 835 (1927); cf. Farmers & Traders Bank v. Thixton etc. Co., 199 Ky. 69, 250 S. W. 504 (1923), where charter power "to do any other thing which is usually done by persons engaged in like business" was held not sufficient to authorize a trading corporation to become an accommodation indorser. McCaleb v. Borne Elect. & Mfg. Co. (Tex. Civ. App. 1915) 173 S. W. 1191 (a corporation "for the accumulation and loan of money" has no authority to indorse notes to raise money for another corporation); Fremont Nat. Bank v. Ferguson & Co., 127 Neb. 307, 255 N. W. 39 (1934) (the provision that a corporation may exercise all the powers which a natural person could do is limited by the other provisions of the charter); Dench & Hardy Co. v. Hanson, Inc., 247 App. Div. 355, 287 N. Y. Supp. 435 (1st Dept. 1936) semble.

In Taliaferro v. J. S. Cowart & Sons, Inc. (Ga. App. 1933) 171 S. E. 406, it was held that a corporation could not accommodate in the absence of express authority so to do.


11 In Morton v. Lovell Bldg. Co., 43 Wyo. 81, 297 Pac. 799 (1931), it was said that, "The authorities make it perfectly clear that the issue or indorsement of negotiable paper by a corporation for the accommodation of another is ordinarily ultra vires." Monument Nat. Bank v. Globe Works, 101 Mass. 57 (1869); COOK, CORPORATIONS (8th ed.) 3523; 1 DANIEL, op. cit. supra note 3, at 440; 3 THOMPSON, COMMENTARIES ON THE LAW OF CORPORATIONS (3d ed.) 992.

12 Globe Indemnity Co. v. McCullom, 313 Pa. 135, 169 Atl. 76 (1933); 6 FLETCHER, CYC. CORP. (Perm. ed. 1931) 456.
of a trend towards the adoption of a rule which would permit all those corporations to accommodate gratuitously which have either charter or statutory authority to become surety or guarantor.

If the act is one of accommodation in the strictly technical sense, consideration received for the loan of the corporate signature in no wise changes the nature of the act. Nor would the acceptance of security by a corporation for its becoming an accommodation party to negotiable paper remove the corporation from the statutory definition. That there is no distinction between a corporation's authority to accommodate gratuitously and its authority to accommodate non-gratuitously is evident. The same general rules are, therefore, applicable to both.

It would seem that where a corporation receives indirect benefits for the pledge of its credit, the transaction is nevertheless one of accommodation in the strictly legal sense. Although the same rules that were used in connection with the other types of corporate accommodation can again be used, nevertheless this third type presents much difficulty.

One authority maintains that, "A corporation is not precluded from issuing or indorsing paper for the benefit of another where it has the power, express or implied, to become surety or guarantor." 6 Fletcher, op. cit. supra note 12, at 454. To the same effect see 14a C. J. 734.

In Thomas v. E. G. Curtis Sons Co., 7 F. Supp. 114 (D. C. Mich. 1934), the court said by way of dictum: "Furthermore, the court is inclined to interpret the statute of Michigan (allowing corporations to become guarantors) as including power to execute accommodation papers." But see Note (1934) 33 Mich. L. Rev. 94, which criticizes this conclusion.

Section 10-i of Art. 327 of Mich. Pub. Acts of 1931 which provides: "Every corporation * * * shall have power to guarantee * * * evidence of indebtedness created by, any other corporation * * *." For a list of similar provisions in sixteen other states see Note (1934) 33 Mich. L. Rev. 94, at 96. Cf. N. Y. Stock Corp. L. § 19 (guaranty of bonds).


In the absence of a charter giving such power, an accommodation indorsement given by a corporation is ultra vires, though it takes security for its supposed liability. Carlafes v. Goldmeyer Co., 72 Misc. 75, 129 N. Y. Supp. 396 (1911).

In re Bankers' Trust, 27 F. (2d) 912 (D. C. Ga. 1928); Farmers and Traders Bank v. Thixton etc. Co., 199 Ky. 69, 250 S. W. 504 (1923); Western Maryland Ry. v. Blue Ridge Hotel Co., 102 Md. 307, 62 Atl. 351 (1905); W. C. Bowman Lumber Co. v. Pearson (Tex. Civ. App. 1911) 139 S. W. 618; Colman v. Eastern Counties Ry. (Eng.) 10 Beavan 1 (1846); 7 Am. & Eng. Encyc. of Law (2d ed. 1892) 789; see Central Trans. Co. v. Pullman, etc. Co., 139 U. S. 24, 35, 11 Sup. Ct. 478 (1891); cf. Thompson v. Whitney & Marsh, 17 Hawaii 107 (1905), where the court said: "It is enough if the benefit is received indirectly, provided always that the indorser's object in making the indorsement is a legitimate object in connection with its regular corporate business."
This difficulty is caused by the inability of the courts to draw any well-defined borderline between those transactions which will directly benefit the corporation and those which will indirectly do so. At one extreme, there are to be found those transactions whereby benefits accrue to the corporation "by way of reaction", and at the other extreme, those transactions which directly benefit the corporation. Between these two extremes, there exists a shadowy middle ground of no mean proportions. The decisions and textbooks have attempted to fix a line of demarcation by resorting to various definitions and tests. A study of these reveals a number of guiding principles which will now be considered.

All the authorities agree that a corporation may pledge its credit, if such pledge is reasonably necessary in the conduct of its business. Under such circumstances, the corporation might be "accommodating" another. However, since the corporation is directly interested in the transaction, the courts would label the corporation "more than a mere accommodation party". Actually, this is a misnomer; the corporation is not an accommodation party for it receives value for the instrument.

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18 The same situation exists in regard to contracts of suretyship and guaranty. See 6 Fletcher, op. cit. supra note 12, c. 26.

19 Cf. Morawetz, TREATISE ON THE LAW OF PRIVATE CORPORATIONS (1886) § 362, where the author states: "No rules can be framed which would be of any practicable value in determining cases of this character * * *".


21 If there is sufficient consideration accruing to the maker of the note, he is not an accommodation party in the legal meaning of the word, even though he signed for the "accommodation" of another. McQueen v. First Nat. Bank, 36 Ariz. 74, 283 Pac. 273 (1929).


The same vague use of the word "accommodation" is found in A. Leschen & Sons Rope Co. et al. v. Brown, 71 F. (2d) 745 (C. C. A. 4th, 1934), where the court, quoting from the defendant's brief said: "It is recognized that an ordinary business corporation has the power to give an accommodation indorsement if made for a proper corporate purpose." However, after deciding that the note in question was indorsed for a proper corporate purpose, the court corrected itself by saying: "* * * in this case the elements of accommodation were lacking in the indorsement the corporation gave."

It is perfectly clear that a corporation which binds itself by negotiable paper for the benefit of another is not an accommodation party, if there be a reasonable expectation that its legitimate business will thereby be directly protected or advanced. In determining whether negotiable paper which a corporation has issued, accepted or indorsed is accommodation paper or is for the protection or advancement of the corporation’s own interests, the courts look to the substance of the transaction and not merely to its form.24 The courts, applying these principles, have recognized a corporation’s authority to bind itself by what seemed to be accommodation paper in the following classes of cases:

(a) Where the corporation assumes what appears to be the obligation of another, whereas, in fact, it is the obligation of the corporation itself;25

(b) Where the corporation receives a large addition to its assets in consideration of its execution, acceptance or indorsement of commercial paper to pay the debts of another;26

(c) Where the corporation indorses the notes of its debtor to enable the latter to improve his business position and to increase the prospect of such debtor paying his indebtedness;27

(d) Where the corporation extends its credit in an effort to save itself from a loss imminent under some lawful contract;28

Packer House Hotel Co., 83 N. J. Eq. 459, 91 Atl. 1027 (1914); American Nat. Bank & Trust Co. of Danville v. Kushner, 162 Va. 378, 174 S. E. 777 (1934) (an indorsement made by a corporation for the advancement or protection of its own interests is not an accommodation indorsement).

For what constitutes value see N. I. L. § 51.


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26 Ellis v. Citizen’s Nat. Bank, 25 N. M. 319, 183 Pac. 34 (1918), where the court said: “* * * and the fact that it (pledge of credit) may redound incidentally to the benefit of another does not invalidate the transaction.” Cf.
(e) Where the corporation assumes the obligation of another in order to obtain complete performance of a contract made for a proper corporate purpose; 29

(f) Where the corporation pledges its credit for the purpose of assuring the prompt performance of a contract which will result in immediate and substantial benefits to the corporation; 30

(g) Where the corporation assumes the business debts of an individual whose business it has taken over; 31

(h) Where the corporation acquires the business and capital stock of another corporation, and executes its notes in exchange for the notes of the latter; 32

(i) Where the corporation controls another corporation and executes, accepts or indorses negotiable paper for the benefit of its subsidiary; 33

(j) Where the corporation assumes the obligation of a valuable employee for the purpose of retaining him; 34 and


30 Where a land development corporation undertakes to secure the establishment of a steel plant at a town site that is being developed, and its officers indorse notes before delivery to the payee in consideration of the prompt establishment of the steel plant at the site of the development, it is more than a mere accommodation indorser and its indorsement was given for a valuable consideration. Talmadge v. Clewiston Iron Co., 252 Ill. App. 508 (1929).


35 The ratio decidendi in these cases was the unity of enterprise rather than the identity of stockholders.

As to the extent of the pledge permissible see Pottlitz v. Public Utilities Commissioner, 96 Ohio St. 49, 117 N. E. 149 (1917).

34 Cf. M. Burg & Sons v. Twin City etc. Co., 140 Minn. 101, 167 N. W. 300 (1914).
(k) Where the corporation extends financial aid to a manufacturer to enable him to furnish the corporation with materials essential to the corporation's functioning as a producing or distributing unit.

A further application of these principles uncovered the following types of transactions whereby a corporation may receive remote benefits only:

(a) Where a corporation pledges its credit in order to retain a client who is in serious financial difficulty, if not insolvent; 37

(b) Where a corporation pledges its credit for the part payment of a musical festival or other gathering to be held in the city in which it does business for the purpose of increasing its business; 38

(c) Where a corporation assumes an obligation of a corporation controlled by one of its officers; 39

(d) Where two corporations engaged in unrelated enterprises have common stockholders, and either of the two issues bills or notes for the benefit of the other; 40

(e) Where a corporation indorses for the benefit of a stockholder, even though he be a principal stockholder; 41 and

(f) Where a corporation makes a loan of its credit for the purpose of benefitting its officers, agents or employees, and nothing more is shown. 42

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38 Military Interstate Assoc. v. Savannah etc. Ry., 105 Ga. 420, 31 S. E. 200 (1898); Davis v. Old Colony Ry., 131 Mass. 258, 41 Am. Rep. 221 (1881); Davis v. Smith American Organ Co., 131 Mass. 255 (1881) (reported with preceding case) cf. Richelieu Hotel Co. v. International Military Encampment, 140 Ill. 248, 29 N. E. 1044 (1892) (guaranty by a hotel company of part of the expenses of a nearby exhibition upheld); B. S. Green Co. v. Blodgett, 159 Ill. 169, 42 N. E. 176 (1895) (a subscription to a post office building was held valid as tending to increase the number of people who would pass the store of the subscriber, which store was located nearby).
42 6 Fletcher, op. cit. supra note 12, at 374. Contra: Liability of a Corporation on Its Guaranty of Another's Obligation (1928) 28 Col. L. Rev. 1089, which contends that, "Guaranties made for the purpose of benefiting employees have caused little difficulty ** ** **", and cites M. Burg & Sons v. Twin City etc.
Whether a corporation receives a direct benefit by pledging its credit for another's benefit as a means of enabling that other to purchase its goods is a question as to which there is much diversity of opinion. In these doubtful cases, guiding principles have proved to be of little or no value. However, it is likely that the courts will adopt the same reasoning applied in similar cases involving guaranties, and resolve this question in the affirmative.

Where a corporation issues or indorses bills or notes in connection with a transaction which is without the defined scope of its business, the act is unquestionably ultra vires. A corporation has no authority to become party to negotiable paper, accommodation or otherwise, for a purpose foreign to the objects for which it was created.

II.

The second sentence of Section 55 of the Negotiable Instruments Law sets forth the liability of an accommodation party: "Such a person is liable on the instrument to a holder for value, notwithstanding such holder at the time of taking the instrument knew him to be an accommodation party." The Negotiable Instruments Law defines person to include "a body of persons, whether incorporated or not." Judicial pronouncement supports the conclusion that Section 55 refers to corporations as well as to individuals. Therefore, it would seem that this second sentence of Section 55 should operate as the sole determinant of the liability of corporate accommodation parties. Yet the authorities are in accord in holding that this section was not designed to change the law relative to corporate accommodation obligations; the legislature did not thereby intend to extend the au-

Co., 140 Minn. 101, 167 N. W. 300 (1918); cf. (1934) 34 Mich. L. Rev. 421 (the salesman in that case was a valuable employee who had several "live prospects").

11 A. L. R. 554. Contra: "There is a seeming conflict of authority on this subject, but except for a few cases, it is more apparent than real," Woods Lumber Co. v. Moore, 83 Cal. 497, 191 Pac. 905 (1920).

4 For a host of cases see 6 Fletcher, op. cit. supra note 12, at 391, 392; 28 L. R. A. (n. s.) 186, note; Note (1928) 28 Col. L. Rev. 1080, at 1081. Contra: Bauman Lumber Co. v. Rierion (Tex. 1920) 221 S. W. 930, criticized in (1920) 30 Yale L. J. 89.

thority of a corporation to the making and indorsing of accommodation instruments. 50 In short, this section does not preclude a corporation from interposing the defense of ultra vires. 51 And, therefore, in the absence of charter authority to accommodate, a corporation may set up the defense of ultra vires against a holder for value who takes the bill or note with notice that the corporation was an accommodation party thereon. 52

However, a corporation is estopped from employing this defense against a holder for value who takes before maturity without notice of the accommodation character of the corporate obligation. 53 This estoppel is based on the proposition that corporate accommodation paper is an example not of a want of general authority, 54 but rather of an excessive use of such authority in a particular instance. 55 "The rule is that, where a corporation has under any circumstances power

50 (1886); City Bank v. Empire Stone Pressing Co., 30 Barb. 421 (N. Y. 1859); (1922) 22 Col. L. Rev. 680.
52 New Hampshire Nat. Bank v. Garage and Factory Equip. Co., 267 Mass. 483, 166 N. E. 840 (1929); BRANNAN, loc. cit. supra note 50, where the author says that, " *** Section 55 does not say that this additional defense cannot be set up against a holder with notice. ***"
55 As a rule corporations have authority to issue and indorse negotiable instruments in the due course of their business. See 6 FLETCHER, op. cit. supra note 12, at 440.
to issue negotiable paper, a *bona fide* holder for value, taking the paper before maturity, has the right to presume that it was issued under circumstances which gave the requisite authority."  

When a corporation binds itself by accommodation paper without authority, the right of a holder for value to recover obviously depends on whether or not he had notice that the corporation was accommodating another. Notice may be either actual or constructive. At the trial, the burden of proving the accommodation character of the corporate obligation is upon the corporation. After the corporation sustains the burden of proving that it was an accommodation party, the burden of coming forward with the evidence shifts to the holder who must show that (1) he was a holder for value, and (2) he became such without notice that the corporation was an accommodation party. Thus, where the form of the instrument or the nature of the transaction charges the holder with knowledge that the corporation may have been an accommodation party, and the corporate defendant proves the accommodation nature of its obligation, as well as the absence of a charter provision permitting such obligations, judgment will lie in favor of the corporation. However, where the corporation had charter authority to become accommodation party to negotiable paper, it is liable to a holder for value on such paper, even though he knew that the corporation was only an accommodation party. Under such circumstances, the act of accommodation would be *intra vires*; it is permitted by the charter. Under any other circumstances, the execution or indorsement of accommodation paper by

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67 For examples of constructive notice see 6 FLETCHER, op. cit. supra note 12, at 464. "As to whether plaintiff had notice that the note was indorsed for accommodation was a question for the determination of the jury under the evidence." Rosenberg v. Bekenstein, 211 App. Div. 791, 208 N. Y. Supp. 309 (1st Dept. 1925).


a corporation is *ultra vires*, and the corporation is liable only to those who take without notice.

III.

In a recent case, *Dench and Hardy Co. v. Hanson, Inc.*, plaintiff, the second indorser of a promissory note, brought an action against the first indorser, a corporation, to recover the amount paid the holder after protest. The answer of the defendant corporation alleged that at the time the plaintiff received and indorsed the note plaintiff had knowledge that the defendant’s indorsement was an accommodation indorsement and that the defendant had received no consideration. This allegation was based solely on the fact that at the time the note was delivered to the plaintiff by the maker it had thereon the indorsement of the defendant corporation.

At the trial the plaintiff placed the note in evidence, proved the authority of the executing officer to execute and indorse negotiable instruments on behalf of the defendant and also proved that it was a holder for value. The defendant corporation then moved for a dismissal, on which motion decision was reserved, and rested *without offering any evidence*. Both sides moved for judgment and the trial court granted judgment in favor of the defendant. On appeal to the First Department of the Appellate Division, *held*, reversed, and new trial granted.

The court opened its opinion by saying: "It is not disputed that the indorsement by the respondent corporation was an accommodation indorsement." But it would seem to be disputed; seriously disputed. There is no doubt but that the burden of proving want of consideration is upon the self-styled “accommodation party”. And

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"It is interesting to note that the record reads as follows: "*** that the respondent’s indorsement was an accommodation and that respondent had received no consideration therefor." Obviously, the confusion still persists. See notes 2 and 5, supra.

23 Plaintiff did not concede this fact. Cf. Nat. Bank of Newport v. H. P. Snyder Mfg. Co., 117 App. Div. 317, 102 N. Y. Supp. 478 (4th Dept. 1907), where, only after the corporation submitted evidence showing that it received nothing whatever for the note did the court say: "We start, therefore, with the fact established that the note was accommodation paper ***".

25 See cases cited note 58, supra.
the defendant corporation was not relieved of that burden merely because the form of the note gave the plaintiff notice that the defendant corporation may have been an accommodation indorser. Notice that a fact might exist is not equivalent to notice of the existence of such fact. And nothing appears from the record on the subject of consideration. The court's position is rendered even more untenable by the statutory presumption that every person, whose signature appears on a negotiable instrument, is presumed to have become a party thereto for value.

In the course of its opinion the court quotes the following, apparently with approval, from the Pennsylvania case of Putnam v. Ensign Oil Co.: "As to him (holder in due course), the accommodation maker (corporation) is liable on the instrument, notwithstanding that at the time of taking the instrument he knew the maker was only an accommodating party." This case, which has been severely criticized, was "explained"—actually overruled—by the Supreme Court of Pennsylvania in 1934.

From a review of a number of leading Massachusetts cases, the court in the principal case concludes that the mere showing by the corporation that it is an accommodation indorser is not a sufficient defense, even as against a holder with notice; that the corporation must go further and allege and prove that the indorsement is ultra vires. This is undoubtedly the law in New York as well as in Massachusetts. But when the court, depending on an ill-considered

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67 Shientag, J., sitting with the Appellate Term (1st Dept. April, 1935) dissented: "** on the ground that the defendant corporation by relying solely upon the fact that the indorsement was on the note prior to its delivery by the maker, did not show that its indorsement was without consideration and thus for accommodation."

68 N. I. L. § 50; Tex. Rev. St. 1925 art. 5933, § 24; Breckenridge Hotel Co. v. J. M. Radford Grocery Co. (Tex. Civ. App. 1931) 35 S. W. (2d) 464 (the statutory presumption that every person who signs is presumed to have become a party for value, excluded any presumption that corporation indorsing note was an accommodation indorser). But see City Court's ruling on Dench & Hardy Co. v. Hanson, Inc. in N. Y. L. J., Nov. 10, 1934.


70 Brannan, op. cit. supra note 1, at 279. In (1929) 9 Bost. L. Rev. 299, it was said: "The reasons offered by the Pennsylvania court seem to be reasons why these conclusions reached should not have been adopted."

71 Nat. Bank of Shamokin v. Waynesboro Knitting Co., 314 Pa. 365, 172 Atl. 131 (1934), where the court said: "** in that case (Putnam v. Ensign Oil Co.), we did not decide that, where a holder in due course knew that the accommodation party had no power to accommodate, this knowledge would not be a bar to recovery."


73 See cases cited in notes 52 and 62, supra.
dictum in Bacon v. Montauk Brewing Co., 74 states that, "Not every accommodation indorsement by a corporation is ultra vires", and "that the indorsement of the note in suit might have been in furtherance of the respondent's corporate business", it is apparent that it does not grasp the significance of the Massachusetts rule—of the majority rule. That rule holds that, in order to establish a defense good as against a holder for value who takes with notice, the corporation must prove that (1) it performed an act of accommodation, and (2) such act was ultra vires in the sense that it was not specially provided for by charter. 75 In New Hampshire Nat. Bank v. Garage and Factory Equipment Co., 76 the Supreme Judicial Court of Massachusetts allowed the corporation to set up the defense of ultra vires against a holder with notice, but only after deciding that, "Although the point is rather close, we are of the opinion that the corporate powers did not extend to the making of accommodation indorsements." And in Bennett v. Corporation Finance Co., Inc., 77 the same court held that, since the defendant by its charter could indorse notes for the accommodation of others, an act of accommodation would not be ultra vires. The failure of the Appellate Division to follow this reasoning closely accounts for the court's startling contention that an accommodation indorsement by any corporation is intra vires, if it is in furtherance of the corporate business. But—"A corporation would not be an accommodation party * * * where it signs or indorses the instrument in order to accomplish legitimate objects of its own." 78

From a casual reading of Dench and Hardy Co. v. Hanson, Inc., one might well reach the conclusion that New York no longer accepts the majority rule. But this is not so. There was no evidence in that case that the corporation was an accommodation party. Therefore, all that the court said in reference to corporate accommodation paper was dicta.

Conclusions.

1. Section 55 of the Negotiable Instruments Law is declaratory of the common law rule that accommodation is not a defense against

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74 In Bacon v. Montauk Brewing Co., 130 App. Div. 737, 115 N. Y. Supp. 617 (1st Dept. 1909), Loughran, J., said: "I am also of the opinion that the learned referee erred in finding that there was no consideration for the execution of these notes." Therefore, the corporation was not an accommodation party, and the court's discussion of the authority of a corporation to accommodate was dictum.

75 See cases cited note 62, supra.

76 267 Mass. 483, 166 N. E. 840 (1929).

77 258 Mass. 303, 154 N. E. 835 (1927).

78 258 Fletcher, op. cit. supra note 12, at 457. For a list of cases see supra notes 25 to 36, inclusive.

In Fremont Nat. Bank v. Ferguson Co., 127 Neb. 307, 255 N. W. 39 (1934), it was said that, "A contract reasonably adopted for the protection of corporate assets is not accommodation paper."
a holder for value who had notice of the accommodation. But this section was framed to cover the general law of accommodations and not the special case of a corporation doing an ultra vires act. As a result, the stringent common law principles relating to corporate accommodations remain controlling to this very day. A failure to appreciate this fact naturally results in confusion. It goes without saying that the defects in this section should be called to the attention of the legislature.

2. The common law rule is based on orthodox principles of ultra vires. When this rule was adopted corporations were not so numerous. But at the present time corporations control the vast majority of business enterprises. And negotiable instruments executed, accepted and indorsed by corporations constitute the great bulk of commercial paper. In order to satisfy the needs of modern business the negotiation of such commercial paper must be facilitated so far as possible. The prevailing rule, permitting the corporate accommodation party to set up the defense of ultra vires against a holder with notice, acts instead as a clog on free transferability. However, individual and isolated decisions discarding this rule are not desirable inasmuch as they ignore the primary purpose of the adoption of the Negotiable Instruments Law, i.e., “to remove confusion and uncertainty which might arise from conflict of judicial decisions amongst the states.”

The proper solution lies either in the abolition of the doctrine of ultra vires or in the revision of Section 55.

3. The teeth of the common law rule were supplied by a strict construction of the charter terms. During the past fifty years, the courts, cognizant of the needs of expanding business, performed dental extractions by resorting to a liberal construction of charters. From this practice ensued the direct benefit theory. This theory may be expressed as follows: where the obligation is incurred in good faith and in the due course of the corporate business, for the purpose of directly promoting or protecting such business, the corporation is not an accommodation party, and this is so irrespective of what the actual result of the transaction may be. In applying this theory the courts
lay stress upon the substance and not the form of the transaction. If, in the particular transaction, the corporation has the requisite authority to extend its credit outright, it may do so indirectly, and the extension of credit may take any form.\textsuperscript{84} In cases where there is doubt as to whether the corporation was directly interested in the transaction, business custom operates as a make-weight factor.\textsuperscript{85} Stockholders and creditors of corporations cannot be heard to complain that this practice exposes them to undue risks. If the character of the corporate officers does not afford the desired protection, such protection may be obtained in the form of a surety bond.

4. The enactment of remedial legislation has been postponed by the adoption of the direct benefit theory.

HAROLD PELLER.

TORT LIABILITY OF MANUFACTURERS.

The doctrine of liability of manufacturers to remote purchasers and users of articles, who have suffered injury therefrom, has found a permanent place in our jurisprudence. There can be no question of the fact that manufacturers are in some cases liable to the consumer, whether the latter is in privity of contract with the manufacturer or not. The difficult problem is unfolded in an attempt to determine the extent of the liability and to establish principles which will enable us to forecast when a manufacturer will be held liable to a remote consumer, and when he will be relieved of such liability.

There is little or no question concerning the manufacturer's liability to one who purchases directly from him. His liability in such a case is established simply by showing a warranty, either express or implied, or some negligence in the manufacture of the article which resulted in harm to the purchaser. When such a situation arises the problem is elementary. On proof of the breach of the warranty or of the duty to use care the manufacturer is held liable.

The law is not nearly so well settled when the plaintiff has not purchased directly from the manufacturer but from a retailer, who may have bought from the manufacturer, or from a wholesale distributor. The early cases brought into our law the proposition that privity of contract is necessary to recover in tort against the maker of a chattel. Winterbottom v. Wright\textsuperscript{1} is generally regarded as the first case to

\textsuperscript{84} Cf. Rabatt, \textit{Power of Corporations to Execute Guaranties} (1897) 33 Am. L. R. 363.

\textsuperscript{85} Wheeler, Osgood & Co. v. Everett Land Co. 14 Wash. 630, 45 Pac. 316 (1896); (1926) 30 Yale L. J. 89.

\textsuperscript{1} 10 M. & W. 109 (1842) (The plaintiff driver of a stage coach sought to recover from a contractor who had agreed with a third party to keep the stage