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Distinction Between Discount and Purchase

Robert D. Fleming

DISTINCTION BETWEEN DISCOUNT AND PURCHASE.

Money-lending by non-banking institutions has entered upon a period of tremendous expansion in recent years. From the standpoint of public policy, it would seem that such a potential menace should be compelled to subject itself to the salutary supervision and regulation provided for in our own Banking Laws. However that may be, there is no escape from the fact that the Legislature[1] has already spoken on this point in unmistakable terms.[2] Whether the Legislature in its zeal overreached itself and acted unwisely is surely no question for a judicial tribunal.

If these enactments are over-drastic it is for the Legislature to undo its mischief, and not for the courts.[3] For, of course, it is not within the province of the courts to question the wisdom of the Legislature. To declare that the Legislature did not mean what it said would be, in effect, sheer judicial usurption of the legislative function.

Yet it appears that in a recent decision, Meserole Securities Co., Inc. v. Cosman,[4] this is exactly what the court has done. In the instant case, the plaintiff, a domestic corporation organized under the Stock Corporation Law,[5] sued to recover upon two promissory notes made and delivered by a corporation, Bischoff, Inc.,

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[1] Article II, Section 22, of the General Corporation Law of the State of New York provides: (1929) (formerly Section 29, renumbered 22, Amended by L. 1929, Ch. 650, Sec. 1).

"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, except as permitted by such laws, *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, of receiving deposits, of buying and selling bills of exchange, or of issuing bills, notes or other evidences of debt for circulation as money, or of engaging in any other form of banking. * * *"

[2] Section 140 of the Banking Laws: Prohibitions against encroachments upon certain powers of banks (L. 1914, Ch. 369).

"No corporation, domestic or foreign, other than a national bank or a federal reserve bank, unless expressly authorized by the laws of the 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,* or issuing notes or other evidences of debt to be loaned or put into circulation as money. *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 of its officers, contrary to the provisions of this section *shall be void.*" (Italics ours.)

[3] Chelten Trust Co. v. National Automatic Press Co., 216 App. Div. 380, 215 N. Y. Supp. 200 (2nd Dept. 1926).

[4] 253 N. Y. 130, 170 N. E. 519 (1930).

[5] Incorporated under the laws of the State of New York, 1922; Stock Corporation Law, Sec. 5, L. 1923, Ch. 787. Derived from Section 2, Bus. Corp. L.

not here a party. The payee was the defendant, Cosman, and he and his co-defendants are sued as indorsers by the plaintiff, a holder in due course and for value. Each note was in the face amount of $4,400 but it is conceded that the plaintiff paid for each only the sum of $4,000.[6]

All of the defendants interposed a defense to the effect that the notes were invalid in the hands of the plaintiff, and that it could not recover thereon, for the reason that it had obtained title thereto contrary to law.[7] Its acquisition of the notes, it was asserted, was in violation of certain statutes, particularly section 140 of the Banking Law,[8] and section 22 of the General Corporation Law.[9]

The trial Court, after hearing the testimony on other branches of the case involving the defendant, Cosman, sustained the defense, adjudged the notes void and dismissed the complaint.[10]

The Appellate Division, by a divided court and with violently conflicting opinions, reversed and ordered a new trial.[11] Brief consideration of both majority and dissenting opinions throws much light on the ultimate disposition of the case. Similarly, in the Court of Appeals, which affirmed the Appellate Division, we have a divided court, *J.* Lehman for the greater part agreeing with *J.* Finch —Pound, O'Brien and Hobbs concurring, and *J.* Kellogg revoicing the opinion of *J.* O'Malley, *J.* Crane concurring.[12]

It is immaterial what the plaintiff claims under its certificate of incorporation, for unquestionably such power is subject to and must yield to the Banking Statute in force.[13]

The sole question before the Court was whether a non-banking corporation, which had engaged in numerous and repeated transactions of discounting notes, could recover on notes so discounted in the face of the express prohibition of former section 22 (now 18) of the General Corporation Law,[14] and in the face of the positive and mandatory language of section 140 of the Banking Law, which unequivocally states that the *notes so discounted are void.*[15]

It is difficult in the face of all authorities to agree with the Court in saying that the notes at issue were merely *"purchased"* and not *"discounted."* Our first problem is to define the proper significance of the term "discount" and so determine whether the notes at issue were discounted or purchased.

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[6] These facts were conceded and set forth in a stipulation read into the record at the trial.

[7] *Supra* notes 1 and 2.

[8] *Supra* note 2.

[9] *Supra* note 1.

[10] 131 Misc. 361, 226 N. Y. Supp. 667 (1928).

[11] 226 App. Div. 21, 234 N. Y. Supp. 260 (1st Dept. 1929).

[12] *Supra* note 4.

[13] New York State Loan & Trust Co. v. Helmer, 77 N. Y. 54 (1879); Pratt v. Short, 79 N. Y. 437 (1880).

[14] *Supra* note 1.

[15] *Supra* note 2.

Baldwin's Century Edition of Bouvier's Law Dictionary, under title "Discount," states:

> "There is a difference between *buying* a bill and *discounting* it. The *former* word is used when the seller does not endorse the bill and is not accountable for its payment." [16] (Italics ours.)

And in similar vein:

> "Buying a Note Distinguished From Discount. 'Buying a note' as distinguished from discounting a note, is used when the seller does not discount the note and is not accountable for its payment." [17]

The distinction that Bouvier draws between purchase and discount is supported by weighty authority.[18] In every single instance, without exception, wherever and whenever a distinction is drawn between purchase and discount, the point of difference is declared to be precisely this, that in the transaction of discount, the seller endorses his name on the instrument, thus making himself personally liable thereon.[19] Where the transfer of the note is made by assignment or by endorsement without recourse, it is a purchase rather than a discount, for in such case the seller is not accountable for its payment.[20] The distinction between purchase and discount depends upon just this fact of personal liability of the seller through endorsement.[21]

From the foregoing, since the defendants in the case at bar were sued as endorsers, no conclusion can be drawn other than that the transaction was one of *discount*.

We turn then to the interpretation of the statutes involved, the restrictions of section 18[22] and the prohibitions of 140.[23]

It is not necessary to dwell at any great length upon the construction to be given to the two statutes herein involved. They are in no way ambiguous, and hence there is no need for judicial

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[16] Bouvier's Dictionary (1927), p. 204.

[17] (1925) 13 Ky. L. Rev. 777.

[18] Metcalf v. Morse Iron Works, 14 N. Y. Anno. Cases, 28, 84 N. Y. Supp. 582 (1st Dept. 1903); Am. & Eng. Encyc. of Law (2nd ed. 1905), p. 471; Black's Law Dict. (2nd ed. 1910), p. 374; Bank v. Baldwin, 23 Minn. 206 (1878).

[19] Freeman v. Brittin, 17 N. J. L. 191, 206 (1839).

[20] Farmers & Mechanics Bank v. Baldwin, 23 Minn. 198 (1878); Freeman v. Brittin, *ibid.*

[21] Magee on Banks and Banking (3rd ed. 1909), p. 428.

[22] *Supra* note 1.

[23] *Supra* note 2.

interpretation.[24] When plain specific language is used, the meaning may not be changed, nor can there be a departure from such meaning in deference to any supposed intent.[25] It is only when the language of a statute leaves some doubt as to its purpose and intent that rules of construction are to be exercised.[26] These statutes are commonly known as "Restraining Acts," for a reason best understood by their captions—"Prohibition of Banking Powers," [27] and "Prohibitions Against Encroachments Upon Certain Powers of Banks." [28]

The first "Restraining Act" was passed in 1804, re-enacted in 1813,[29] and extended in 1818.[30] The purpose of these acts was to exclude corporations, associations and individuals, *other than banks so authorized to act,* from conducting a banking business in either department of issue, deposit, or discount.[31] In 1837, the Legislature repealed those restrictions pertaining to *individuals* and *unincorporated associations only,* from keeping offices of deposit and discount.[32] Any individual or unincorporated association could then discount commercial paper.[33] With the intent of the Legislature so clearly indicated and defined,[34] let us weigh the opinions in the instant case.

Despite the fact that today we have virtually a restatement of the former "Restraining Acts" in our current laws,[35] after a century or more the Court decides that these statutes do *not* mean what they clearly say—that discounting, when taken by itself, though done repeatedly and continually, is not prohibited by statute, nor are the notes dealt with in such transactions void. They say that the restriction applies *only* when such discounting is a part of the business of banking.[36]

Can it be conceived that such construction would be resorted to in the event that some other function peculiar to banks, such as "receiving deposits" or "issuing notes to be put into circulation as money," had been exercised?

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[24] People ex rel. N. Y. Cent. & H. R. R. Co. v. Woodbury, 208 N. Y. 421, 102 N. E. 566 (1913); People ex rel. L. & N. Y. R. R. Co. v. Sohmer, 217 N. Y. 443, 112 N. E. 181 (1916).

[25] Benton v. Wickwire, 54 N. Y. 225 (1876); In re Village of Middleton, 82 N. Y. 196 (1880); People v. L. I. R. R. Co., 194 N. Y. 130, 87 N. E. 79 (1909); People ex rel. Rand v. Craig, 231 N. Y. 216, 131 N. E. 894 (1926).

[26] *Supra* notes 24, 25.

[27] *Supra* note 1.

[28] *Supra* note 2.

[29] 2 Rev. Stat. 234.

[30] Laws 1818, Ch. 236.

[31] N. Y. Firemen's Institute v. Ely & Parsons, 2 Cow. 678 (N. Y. 1824).

[32] Laws 1837, Ch. 20.

[33] Curtis v. Leavitt, 15 N. Y. 97 (1857).

[34] *Ibid.*

[35] *Supra* notes 1 and 2.

[36] *Supra* note 4.

But O'Malley, *J.*, of the Appellate Division, in his dissenting opinion makes no effort to distort the obvious meaning expressed by the simple language of the statute, and his conclusion is supported not only by a resumé of decided cases, but by a simple and convincing analysis of the grammatical construction of the statute.[37] This opinion, confirmed by Kellogg, *J.*, of the Court of Appeals,[38] disperses all doubt that the transactions by the plaintiff in the case at bar were wholly in defiance of clearly written statutes—statutes which have been repeatedly re-enacted in order to secure the public from any unscrupulous corporations who make a practice of such illegal discounting of notes and which are susceptible of but one interpretation.

ROBERT D. FLEMING.

EFFECT OF FALSITY OF MATERIAL REPRESENTATIONS IN AN INSURANCE POLICY.

It is an elementary rule of agency that notice acquired by an agent during the transaction which it affects, binds the principal as fully as if he acquired the notice in person, even though the agent does not in fact inform the principal.[1] An exception is made to this rule where an agent is engaged in a scheme to defraud his principal. In such a case the presumption that the agent will communicate all material facts to his principal no longer prevails, and the principal is not bound by the knowledge acquired by his agent while engaged in such fraudulent purpose.[2]

Another important exception to the general rule stated is brought about, in New York, by section 58 of the Insurance Law.[3] This section states that the policy and anything attached thereto consti-

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[37] *Supra* note 11.

[38] *Supra* note 4.

[1] Jefferson County Bank v. Dewey, 197 N. Y. 14, 90 N. E. 113 (1909); Small v. Housman, 208 N. Y. 115, 101 N. E. 700 (1913); Corrigan v. Bobbs-Merrill Co., 228 N. Y. 58, 126 N. E. 260 (1920).

[2] Natl. Life Insurance Co. v. Minch, 53 N. Y. 144 (1873); Crooks v. Peoples Natl. Bank, 177 N. Y. 68, 69 N. E. 228 (1903); Prudential Insurance Company v. Natl. Bank of Commerce, 227 N. Y. 510, 125 N. E. 824 (1920).

[3] "Every policy of insurance issued or delivered within the state on or after the first day of January, 1907, by any life insurance corporation doing business within the state shall contain the entire contract between the parties and nothing shall be incorporated therein by reference to any constitution, by-laws, rules, application or other writings unless the same are endorsed upon or attached to the policy when issued, and all statements purporting to be made by the insured shall in the absence of fraud be deemed representations and not warranties. Any waiver of the provisions of this section shall be void."