

WILLIAMS and SINKLER
Attorneys at Law
601 Commercial Trust Building
PHILADELPHIA.

X-4394

August 3, 1925.

Walter Wyatt, Esq., General Counsel
Federal Reserve Board
Washington, D.C.

Dear Mr. Wyatt:

I am writing to bring to your attention a case recently decided by the Superior Court of the State of Pennsylvania. The case is reported at page 52 of Volume 85 of the Pennsylvania Superior Court Reports, and was decided on February 27th, 1925. It has recently come to my attention in the advance sheet form, and inasmuch as there are no extra copies on hand I am unable to send you a complete report of the case. It may be that you have already seen a copy of it.

The case is interesting inasmuch as it seems to apply the Malloy case doctrine. The effect of the decision is to hold that a bank of deposit receiving an item for collection from its depositor must first prove knowledge on the part of the depositor of a regulation providing that a collecting bank will be liable only for actual funds coming into its possession, before it will be permitted to recover from the depositor an overdraft resulting from the failure to collect the item deposited for collection. In that case the bank of deposit had forwarded the items, which were two certificates of deposit, through ordinary channels for collection. In due course the items came into the hands of the Federal Reserve Bank of Cleveland, and it forwarded the items directly to the bank of issue for collection. The Federal Reserve Bank accepted the bank draft of the bank of issue in payment of the two certificates. Prior to payment of the bank draft, the bank of issue made an assignment for the benefit of creditors and the drawee bank dishonored the draft. The items were charged back in the usual manner and the bank of deposit, by reason of having permitted overdrafts, was forced to bring suit against the depositor for the amount of the two certificates.

The lower court made absolute a rule in favor of the plaintiff bank for judgment against the depositor for want of a sufficient affidavit of defense on two counts, namely:

- "(1) the plaintiff by accepting the deposit certificates did not become the owner and that the bank whose negligence caused the loss to the defendant was the agent of the depositor and not the agent of the bank; and
- (2) that the affidavit of defense did not contain a sufficient allegation of facts to justify a conclusion that the certificates were received by the bank

- 2 -

X-4394

Walter Wyatt, Esq., General Counsel

8/3/25

as cash, or that it became the owner thereof."

The defendant appealed from the judgment of the lower court, and the Superior Court upheld the first contention stating clearly that the law of Pennsylvania had long been settled on the basis of the Massachusetts rule, namely that the liability of the bank of deposit in the absence of instructions or an agreement to the contrary, extends merely to the selection of a suitable and competent agent, with proper instructions, and does not involve responsibility for default and misconduct of the correspondent bank. The Court further upheld the second ground for the decision of the lower court, namely that the allegations of the affidavit of defense were not sufficient to show that the certificates were not received by the plaintiff for collection but were received as cash, and that the plaintiff bank became the owner thereof.

The Superior Court, however, reversed the judgment of the lower court and remitted the record for further proceedings, on the ground that the plaintiff had not averred in its statement of claim that the plaintiff had knowledge or was charged with knowledge of Regulation J of the Federal Reserve Board whereby the Federal Reserve Bank of Cleveland was authorized to limit its liability to cases in which the proceeds of collection items in actual funds came into its hands. The Court in its opinion said:

"The depositor is not bound by the knowledge of its agent of the regulation which provides for variation of the settled law. On what principle of law may such a regulation bind a depositor? Clearly, only if the depositor has knowledge of the regulation when he makes his deposit. The plaintiff avers no such knowledge on the part of the defendant and the defendant denies that he had such knowledge."

Yours very truly

MLS

(Signed) Parker S. Williams.