X-4551

March 9, 1926.

To: Federal Reserve Board

From: Mr. Wyatt - General Counsel.

Subject: Topic for Governors' Conference - Advisability of seeking amendment to restore to Federal courts jurisdiction over suits by and against Federal reserve banks.

It is respectfully recommended that the above subject be placed on the program for discussion at the forthcoming Governors' Conference and that copies of this memorandum be sent immediately to the Governors of all Federal reserve banks in order that they may study the subject and consult with their counsel prior to the Conference.

Prior to the Act of February 13, 1925, the Federal courts had jurisdiction of suits brought by or against Federal reserve banks which involved as much as $3,000, because of the fact that they were Federal corporations. American Bank and Trust Company v. Federal Reserve Bank of Atlanta, 256 U. S. 530. A suit brought by or against a Federal reserve bank, therefore, which involved as much as $3,000 could be brought originally in a United States District Court, and a suit brought against a Federal reserve bank in a State court could be removed to a United States District Court if it involved as much as $3,000.

The Act of February 13, 1925, however, which was recommended by the American Bar Association and by the Supreme Court of the United States and which dealt primarily with the appellate jurisdiction of the Federal courts, contained the following provision:

> "SEC. 12. That no district court shall have jurisdiction of any action or suit by or against any corporation upon the ground that it was incorporated by or under an Act of Congress: Provided, that this section shall not apply to any suit, action, or proceeding brought by or against a corporation incorporated by or under an Act of Congress wherein the Government of the United States is the owner of more than one-half of its capital stock."

This amendment has the effect of depriving Federal courts of jurisdiction of all suits by or against Federal reserve banks unless the pleadings of the plaintiff on their faces actually raise some question necessarily involving the interpretation of the Constitution of the United States or some Federal statute. It is not sufficient for the pleadings of the defendant to raise a Federal question.

Moreover, Federal reserve banks cannot get into the Federal

courts on the ground of diversity of citizenship, because the Supreme Court has held that a Federal corporation is not a citizen of any State. Bankers Trust Company v. Texas and Pacific Railway, 241 U.S. 295. The Federal reserve banks, therefore, have not even as much rights in the Federal courts as have national banks. Section 24(16) of the Judicial Code specifically provides that, for jurisdictional purposes, national banks shall be deemed citizens of the States in which they are located and this enables them to bring suits in the Federal courts or remove suits brought against them to the Federal courts on the grounds of diversity of citizenship where the other parties are citizens of States other than that in which the head office of the national bank is located. There is no law, however, giving Federal reserve banks a similar status.

The present situation is of serious disadvantage to the Federal reserve banks, because they can sue or be sued in the Federal courts only when the initial pleadings show on their faces that the suits necessarily involve the construction of the Constitution of the United States or of some Federal statute; and suits brought against them in the State courts can be removed to the Federal courts only when the pleadings of the plaintiffs show on their faces that the suits necessarily involve the construction of the Constitution of the United States or some Federal statute, and this is rarely the case. It is not sufficient for the Federal reserve bank to plead in defence some provision of the Federal Reserve Act or some Regulation of the Federal Reserve Board (e.g., Regulation J upon which they rely for protection in collecting checks.) Moreover, counsel for a number of the Federal reserve banks advise me that they frequently find both the judges and the juries in the State courts to be unreasonably prejudiced against, and hostile to, the Federal reserve banks; so that it is very difficult for them to get a fair trial in the State courts. For these reasons, counsel for most of the Federal reserve banks feel very strongly that the Federal Reserve System should seek an amendment to the Judicial Code restoring the jurisdiction of Federal courts over suits by and against Federal reserve banks.

I have not brought this question up before, because I was advised informally that a bill probably would be introduced at this session of Congress to amend the Judicial Code in several particulars and I had hoped that it would be possible to have a provision restoring the Federal jurisdiction over suits by and against Federal reserve banks incorporated in such a general statute. This I believe would be much better than to ask for special legislation in a separate statute benefitting the Federal reserve banks alone. I am now advised, however, that the demand for a further amendment to the Judicial Code which was expected to develop has not yet developed and that there seems to be no prospect for such legislation

at the present session of Congress. It becomes important to consider, therefore, whether the Federal reserve banks should seek to obtain the enactment of a special statute restoring the jurisdiction of the Federal courts over suits brought by and against them.

There are a number of ways in which the present situation could be improved by a special amendment to the law:

1. An amendment might be sought either to the Judicial Code or to the Federal Reserve Act providing that, for jurisdictional purposes, Federal reserve banks shall be deemed to be citizens of the States in which their head offices are located, thus placing them upon an equality with national banks and enabling them to get into the Federal courts on the ground of diversity of citizenship when the other party is a citizen of a different State from that in which the head office of the Federal reserve bank is located. Inasmuch as this would only give the Federal reserve banks such privileges as national banks and any ordinary citizen or corporation would have it ought to be comparatively easy to get such an amendment; but such an amendment would grant only partial relief.

2. An amendment might be sought changing that provision of Section 4 of the Federal Reserve Act which authorizes Federal reserve banks "to sue and be sued, complain and defend, in any court of law or equity" so as to authorize them "to sue and be sued, complain and defend, in any United States District Court." This would be similar to a provision contained in the charter of the Bank of the United States which was held by the Supreme Court to be sufficient to confer upon the Federal circuit courts jurisdiction of suits by and against the Bank of the United States. Osborn v. United States Bank, 9 Wheat. (22 U.S.) 737.

3. An amendment might be sought to the above quoted provision of the Act of February 13, 1925, changing the proviso to read somewhat as follows:

> "Provided that this section shall not apply to any suit, action, or proceeding brought by or against a Federal Land Bank, Joint Stock Land Bank, Federal reserve bank or any corporation incorporated by or under an Act of Congress wherein the Government of the United States is the owner of more than one-half of its capital stock."

Such an amendment would simply extend the proviso to cover a few specific classes of corporations, the majority of the stock of which is not owned by the Government but in which the Government obviously has an interest and which obviously ought to be protected to the same extent as corporations in which the Government merely owns one-half of the capital stock. This I believe would be the best kind of

an amendment to seek if any special legislation is sought. It could be supported by unanswerable logic; and, by including the Joint Stock Land Banks, the Federal Land Banks and possibly some other Federal corporations whose position is analogous to that of Federal reserve banks, it might be possible to obtain additional support for the bill and to avoid the appearance of seeking special privileges for Federal reserve banks.

The principle which led Congress to exclude from the provisions of Section 12 of the Act of February 13, 1925, any Federal corporation wherein the Government of the United States is the owner of more than one-half of its capital stock would seem to apply with equal force to Federal reserve banks for the following reasons:

1. Although none of the stock of Federal reserve banks is owned by the United States Government, the Government has a reversionary interest in the surplus of the Federal reserve banks, which amounts to approximately twice as much as the capital of the Federal reserve banks.

2. The Federal reserve banks have taken over the functions of the sub-treasuries and perform many very important services as depositaries and fiscal agents of the Government.

3. While Federal reserve banks are private corporations, nevertheless they are corporations created for public and semi-governmental purposes and are under the supervision of a Board composed of officers of the United States.

4. They were created and actually function as important instrumentalities of the Federal Government, acting not only as depositaries and fiscal agents and performing the functions previously performed by the sub-treasuries but acting also as the media through which the great bulk of our currency is issued.

5. All the net earnings of the Federal reserve banks, after providing for expenses, limited dividends, and the surplus authorized by the Act, go to the Government as a franchise tax; so that the Government has an actual interest in the protection of Federal reserve banks against losses resulting from unfair treatment in the State courts.

The above merely indicates some of the grounds that might be urged as bringing the Federal reserve banks within the principles of the proviso to Section 12 of the Act of February 13, 1925. It is believed that if these were amplified and supported by statistics showing the volume of Governmental operations performed by the Federal reserve banks in their capacities as depositaries, fiscal agents and sub-treasuries of the Government, an unanswerable argument could be built up in support of such an amendment.

In view of the reluctance of the Federal courts to have their jurisdiction enlarged and in view of the prejudice existing against Federal reserve banks in many quarters, however, it is a close question whether it would be desirable or expedient to attempt to seek a special amendment for the relief of the Federal reserve banks even on this obviously sound basis. It is for this reason that I believe it highly desirable to have this subject discussed at length by the Governors of all Federal reserve banks in conjunction with the Board before any attempt is made to obtain legislation.

It has also been suggested that an amendment should be sought exempting Federal reserve banks from the process of attachment and garnishment before final judgment in any case, as national banks are now exempted under the provisions of Section 5242 of the Revised Statutes. I have not given much thought to this question, because I believe the other question discussed above is far more important and should be dealt with first; but it would seem obvious that if Congress has seen fit to exempt national banks from the process of attachment and garnishment pending the rendition of final judgments, it should also exempt Federal reserve banks, which are much more important from a public standpoint and which perform much more important functions as instrumentalities of the Government. For the further information of the Board, I attach a copy of a letter from Judge Ueland, Counsel to the Federal Reserve Bank of Minneapolis suggesting an amendment along this line.

In view of the short time remaining before the Governors' Conference, it is respectfully recommended that a copy of this memorandum and the attached letter from Judge Ueland be sent direct to the Governors of each Federal reserve bank at the earliest possible date and that a copy be sent to the Secretary of the Governors' Conference with advice that the Board has voted to add this topic to the program for discussion at the forthcoming Governors' Conference and has already sent copies of this memorandum direct to the Federal reserve banks in order to save time.

Respectfully

Walter Wyatt
General Counsel.

Copy of letter
attached.

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FEDERAL RESERVE BANK
OF MINNEAPOLIS

X-4551-a

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February 23, 1926.

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

My dear Wyatt:

Congress being now in session I venture to suggest the importance of an amendment to the Federal Reserve Act exempting Federal reserve banks from the process of attachment and garnishment, the same as National banks. In this, the Ninth District, I have been vexed a good deal by a suit started against this bank in a North Dakota state court, with garnishment as basis of jurisdiction, and, of course, for judgment in rem in case of no appearance on the part of the defendant. Without such an amendment as that suggested, it seems to me there can scarcely be any limit to annoyance of that sort, for in the absence of a clear provision in the act exempting Federal reserve banks from attachment and garnishment a claim that they are exempt by implication cannot be maintained so clearly as to have the State courts sustain it.

The Federal reserve banks are also much concerned in having the Act of February 13, 1925 with respect to the jurisdiction of the district courts of the United States amended, for, as you know, Section 12 provides that incorporation under an act of Congress is no longer to give those courts jurisdiction, and the Federal reserve banks having not been given the status of citizenship of any state, the same as national banks, the present situation seems to be that a Federal reserve bank can neither sue in a Federal court or have a suit against it removed from a State to a Federal court unless the suit arises under the Constitution or Laws of the United States, aside from that of being a Federal corporation. It is of course entirely unnecessary to point out to you the practical importance of giving Federal reserve banks the right to litigate their controversies in the Federal courts.

Yours very truly,

(Signed) A. Ueland

A. UELAND
Counsel.

P.S. As to a Federal reserve bank being able to remove a suit against it from a State to a Federal court on the ground that the suit arises under the Constitution or Laws of the United States, please remember the rule that this cannot be done unless the fact of the suit arising under the Constitution or Laws of the United States appears on the face of the complaint. This is hardly ever the case.