FEDERAL RESERVE BOARD

230

WASHINGTON

X-4976

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

October 19, 1927.

SUBJECT: Topic for Governors' Conference.

Dear Sir:

The right of a Federal reserve bank to charge to the reserve account of an insolvent member bank checks received by the Federal reserve bank for collection and transmitted to the member bank for payment prior to insolvency, has been questioned by the receiver of an insolvent national bank as the result of such a charge made by the Federal Reserve Bank of Richmond. The matter has been the subject of correspondence between the Federal Reserve Bank of Richmond and Counsel for the Federal Reserve Board, who has also taken it up with Honorable Newton D. Baker.

The Board has voted to refer the subject to the forthcoming Conference of Governors and accordingly there is enclosed herewith copy of a memorandum relative thereto, addressed to the Board by its General Counsel, together with copies of various communications on the subject.

By direction of the Federal Reserve Board.

Walter L. Eddy,
Secretary.

TO GOVERNORS OF ALL F. R. BANKS

COPY

X-4976-a

Date -October 8, 1927.

To - The Federal Reserve Board

From - Mr. Wyatt - General Counsel

Subject: Right of Federal Reserve Bank to charge to the account of an insolvent member bank checks received by the Federal Reserve Bank for collection and transmitted to such member bank for payment prior to insolvency.

I respectfully submit herewith for the Board's information a copy of certain correspondence between this office and Mr. M.G. Wallace, Counsel to the Federal Reserve Bank of Richmond, on the above subject. I am calling this to the Board's attention because of the fact that it involves a controversy which is about to be made the basis of a test suit involving legal questions of interest to the entire Federal Reserve System, and it has occurred to me that it may be advisable to make this a topic for discussion at the Governors' Conference.

The facts may be summarized briefly, as follows: The Federal Reserve Bank of Richmond received certain checks for collection pursuant to the terms of Regulation J and forwarded them to the drawee bank for payment. After such checks had been received by the drawee bank and charged to the drawers' accounts, but before the time for payment stipulated in the time schedule had elapsed, the drawee bank failed and a receiver was appointed. Subsequent to the insolvency of the drawee bank the Federal Reserve Bank of Richmond charged the amount of such checks to the reserve account of the drawee bank and credited same to the banks from which they had been received. Subsequently, the receiver questioned the right of the Federal Reserve Bank to charge such checks to the insolvent bank's reserve account and demanded that the Federal Reserve Bank account to him for the reserve balance of the insolvent bank without deducting the amount of such checks. The Federal Reserve Bank thereupon notified the banks from which the checks were received of the position taken by the receiver and advised such banks that if the Federal Reserve Bank was required to refund the amount of such checks to the receiver, it would charge same to the account of the banks from which the checks had been received. Some of the banks from which these checks had been received then notified the Federal Reserve Bank that they would not permit the Federal Reserve Bank to charge such checks back to their accounts, but would hold the Federal Reserve Bank responsible for the amounts thereof on the ground that the checks had been collected.

The receiver takes the position that, inasmuch as the Federal Reserve Bank was acting merely as agent in collecting such checks, it had no right to offset the amount thereof against the reserve account of the drawee bank. Purely as a question of offset, this position is sound, because the accounts were not mutual and no offset is permissible under such circumstances.

The Federal Reserve Bank, however, relies upon the provisions of its check collection circular wherein it reserves the right "to charge a cash letter to the reserve account of the member bank at any time when in any particular case it deems it necessary to do so." This provision was inserted in the check collection circular of the Federal Reserve Bank of Richmond pursuant to the authority contained in Section V(4) of Regulation J, which provides that:

> "Any Federal reserve bank may reserve the right in its check collection circular to charge such items to the reserve account or clearing account of any such bank at any time when in any particular case the Federal reserve bank deems it necessary to do so."

The legality of the above quoted provision of the Board's regulations and of the Federal Reserve Bank's check collection circular has never been tested in the courts and is somewhat doubtful. I seriously doubt that the Federal Reserve Board or the Federal Reserve Bank has the right to compel a member bank to pay a check which the Federal Reserve Bank does not own but is handling merely as agent by permitting same to be charged to the drawee bank's account, unless the drawee bank consents to such charge. This provision was inserted in Regulation J on the theory that, by forwarding checks to Federal Reserve Banks for collection under the terms of Regulation J, and by remitting to the Federal Reserve Banks for checks under the terms of Regulation J, the member banks would be held to have acquiesced in the terms of that regulation and to have authorized the Federal Reserve Banks to charge such checks to their reserve accounts. Such authorizations would be continuous; but it may be argued with much force that the authority thus given would be revoked automatically upon the insolvency of the drawee bank and that, therefore, the Federal Reserve Bank has no right to charge checks to the drawee bank's account after the drawee bank becomes insolvent.

If the court should merely rule that the Federal Reserve Bank has no right to charge a check to the reserve account of an insolvent member bank, I do not believe the decision would do much harm; but there is a danger that the court might go much further by way of dictum and say that the Federal Reserve Bank has no right under any circumstances to charge a check to the reserve account of the drawee bank unless the drawee bank authorizes the charge. While such a dictum would not be absolutely binding upon the Federal Reserve Bank, it would raise such serious doubts as to the legality of the above quoted provision of the Board's Regulations and of the check collection circulars as to greatly impair, if not utterly destroy, their usefulness, and I think this would be quite unfortunate.

In view of all these circumstances, I believe it would be advisable to place this subject on the program for discussion at the next Governors' Conference, in order that the Governors might discuss with Mr. Seay the advisability of making a test suit on this question and might also discuss the practical problems involved in connection with the charging of checks to the accounts of drawee banks.

Respectfully,

Walter Wyatt
General Counsel.

Papers attached

WW OMC

October 18, 1927.

Mr. George J. Seay, Governor,
Federal Reserve Bank,
Richmond, Virginia.

Dear Governor Seay:

I have received your letter of October 14th with reference to the controversy between the Federal Reserve Bank of Richmond and the Receiver of the Farmers & Merchants Bank of Lake City and have already submitted your letter to the Federal Reserve Board and called it personally to the attention of Governor Young.

You state that you understand my view to be that the question involved in this case will only become a System matter in case the Judge should introduce some dictum not necessary to a decision. That is not exactly my view. Inasmuch as the point of law which will actually be decided in this case will necessarily affect all the Federal reserve banks, I think the case is inherently one of such a nature that it should be called to the attention of all Federal reserve banks, and that the Governors' Conference should have an opportunity to decide whether or not it desires to have the case made a System case. I feel, however, that the right to charge checks to the drawee bank's account subsequent to insolvency is relatively unimportant and that it would not do much harm if that question is decided adversely to the Federal reserve banks. On the other hand, I feel that the question of the right to charge checks to the drawee bank's account prior to insolvency, which might be affected by a dictum in this case, is of much more importance and that it would be unfortunate if in deciding this case the Court should indulge in a dictum which would raise doubts as to the right of a Federal reserve bank to charge checks to the account of the drawee bank prior to insolvency.

I am not inclined to recommend that this case be settled out of court or that the Federal Reserve Bank of Richmond surrender its rights in the premises. The Office of the Comptroller of the Currency apparently is determined to have this question settled by a test suit; and, so far as I have been able to ascertain, the case which you have pending is free of any complications and should make a good test case. The only possible advantage to be derived from the settlement of this case out of court and the consequent surrender by the Federal reserve banks of their right to charge checks to the

drawee bank subsequent to insolvency would be to avoid the possibility of a dictum casting a doubt upon their right to charge checks to the drawee bank's account prior to insolvency; and I doubt that this advantage is sufficient to justify all the Federal reserve banks in surrendering what many of them consider an important legal right and in asking the Federal Reserve Bank of Richmond to suffer a serious financial loss. I feel, therefore, that it is just as well to try the case you have pending; but I consider it my duty to call it to the attention of the Federal Reserve Board and the other Federal reserve banks, because it is in the nature of a test case on a question of law which will affect all of the Federal reserve banks.

I sincerely trust that this letter will serve to make my position entirely clear and that you and Mr. Wallace will agree that I have done the right thing in recommending to the Board that this case be put on the program for discussion at the Governors' Conference. I agree with you that the questions of law could be discussed more appropriately by the Counsel of the various Federal reserve banks than by the Governors; but there are certain practical questions which I think should be considered by the Governors. I believe that placing the subject on the program for discussion at the Governors' Conference will serve a double purpose, since the Governors can discuss the practical questions involved and undoubtedly each Governor will ask his own Counsel for an opinion on the question of law.

If the Governors decide to have this question considered in more detail by the Counsel to the Federal reserve banks I shall be very glad, with the approval of the Federal Reserve Board, to arrange for a joint conference of Counsel of all the Federal reserve banks to discuss this and other legal matters of System interest. We have held two such conferences heretofore and it seems to be the unanimous opinion of Counsel that they have been very helpful.

With kindest personal regards, I am

Sincerely yours,

Walter Wyatt,
General Counsel.

WW sad

COPY

X-4976-c

FEDERAL RESERVE BANK OF RICHMOND.

October 14, 1927.

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

Dear Mr. Wyatt:

Mr. Wallace has shown me your letter to him of October 8 relating to a controversy between this bank and the receiver of the Farmers & Merchants Bank of Lake City, accompanied by a copy of your letter to the Federal Reserve Board, in which you recommend that the matter be placed on the program for discussion at the next Governors' Conference.

I have reviewed the case and all of the correspondence which has passed between you and our Counsel, Mr. Wallace, and it seems to me that the subject is entitled to much more consideration, in detail, than it is usually practicable to give at these conferences of governors. As a rule, a matter of this kind would, I think, be referred by each governor to the counsel of his bank for study and opinion. In order to get the merits of the case fully before the conference, a statement of all the facts should be presented, and I think it would be desirable, if not necessary, to read at length from the correspondence which has passed between you and our Counsel, in order to develop the niceties of the case.

There seems to be, in some measure, differences of opinion between yourself and Mr. Newton D. Baker as to whether this case is likely to become a System matter. As I understand your point of view, it will only become a System matter in case the Judge should introduce some dictum not necessary to a decision in the case, and while no one can say how great that danger may be, you have fear of it and it must be regarded as a possibility. It hardly seems to me that the danger of that possibility would justify this bank in withdrawing from the case and assuming the loss which would ensue. The amount involved in the case of the Lake City bank is covered by two remittances, aggregating about $34,000; the amount involved in a similar case with respect to the Fayetteville bank is, I believe, in the neighborhood of $20,000, making the total sum involved approximately $54,000. As an offset, we would receive the dividends paid by the receivers of the respective banks, which in the case of the Lake City bank we are led to believe will be very substantial, but which in the case of the Fayetteville bank cannot even be approximated at the present time.

The Conference of Governors, it seems to me, would be likely to take one of only two courses: either recommend that the Federal Reserve Bank of Richmond withdraw from its position and assume the loss; or recommend that the matter be referred to the counsel of the several banks for an opinion as to whether the possible danger to the System would seem to make it advisable for the Richmond bank to withdraw. We should hardly be willing to take the first course upon the suggestion of the Conference because, in the nature of the case, we believe it could only be superficially considered in a general discussion within the time available; but we might be willing to follow the recommendation of the counsel of the several banks should there be any uniform concurrence of opinion among them, and if the other banks adopted the opinion of counsel.

In one of Mr. Wallace's letters to you, he suggested that a statement of the facts be submitted to the counsel of the several banks for consideration and expression of opinion. This course, in my judgment, would be preferable to discussion at the Conference. Whether Mr. Baker had reviewed the entire case when he wrote the letter to you on June 18, I do not know, but if not the same matter submitted to the counsel of the banks might, also, be submitted to Mr. Baker, should the Board think it advisable. In considering the effect of an embarrassing court decision upon the System, it is well to bear in mind that only two of the Federal Reserve Banks, Philadelphia and Richmond, pursue the deferred charge practice; the rest have the remittance plan.

I am writing this letter directly to you rather than to the Board because this course seems to me to offer the most convenient manner of placing the matter before the Board, and I suggest that you bring the letter to the attention of the Board along with your communication to the Board of October 8.

Very truly yours,

(Sgd.) Geo. J. Seay,
Governor.

GJS CCP

October 8, 1927.

Mr. M. G. Wallace, Counsel,
Federal Reserve Bank of Richmond,
Richmond, Virginia.

Dear Mr. Wallace:

I have received your letter of August 20th with further reference to the controversy between your bank and the receiver of the Farmers & Merchants National Bank of Lake City, but have not replied more promptly because I have been absent from the office much of the time and have been exceedingly busy during the time I have been in the office.

After reading your letter I can realize that you find yourself "between the devil and the deep blue sea" and that you are practically forced to try a law suit on this question either with the receiver or with the member banks from which you received the checks in question, unless the Federal Reserve Bank of Richmond wishes to settle the case and absorb the necessary financial loss which I judge the bank is unwilling to do.

In view of the fact that the legal question involved in this case will affect all of the Federal reserve banks, I am calling this matter to the attention of the Federal Reserve Board with the suggestion that it put the subject on the program for discussion at the forthcoming Governors' Conference. If the Board adopts this suggestion, it will give the Governors an opportunity to discuss the matter from a System standpoint and to consider the practical as well as the legal questions involved.

With all best wishes, I am,

Cordially yours,

Walter Wyatt,
General Counsel.

P.S. For your information I enclose a copy of the memorandum which I am submitting to the Board.

COPY

X-4976-e

FEDERAL RESERVE BANK OF
RICHMOND

August 20, 1927.

Federal Reserve Board,
Washington, D. C.

ATTENTION OF MR. WALTER WYATT General Counsel.

My dear Mr. Wyatt:

I have your letter of August 17th with reference to the controversy between this bank and the Receiver of the Farmers & Merchants National Bank of Lake City.

I have, of course, considered your letter carefully, and have discussed it with the officers of this bank. I am rather inclined to agree with Mr. Baker in thinking that the question involved in this controversy is so remote from the question involved in the Atlanta district that there is little chance that a decision in one case will have any bearing upon the other, but, of course, none ofus can foresee what some Judge may undertake to say by way of obiter dicta.

In my case there could be no doubt of our right to charge the reserve account of the member bank if it remained solvent. The sole question involved would be whether or not the insolvency of the member bank revokes the authority which it has given to us to charge its account, and, if so, whether or not the revocation operates with respect to charge which could have been made before the closing of the bank, but in fact were not so made. In the Atlanta case the question is whether or not the member bank may evade the spirit of the Federal Reserve Act by refusing to pay checks presented through the Federal Reserve Bank if the drawer has directed that such checks shall not be paid to the Federal Reserve Bank.

In any event, I see little chance of our avoiding a settlement by litigation of the point in controversy. As you know, our claim involves two letters. The first of these letters was sent to the Farmers & Merchants National Bank of Lake City on October 7th, and under our time schedule was chargeable to its reserve account on Monday, October 11th. The checks in the letter were cancelled on October 8th. The bank was closed on Saturday, October 9th. On October 11th the reserve account was adequate to meet this letter, and we accordingly charged the letter to the reserve account and credited the banks from which the checks had been received.

We sent to the Receiver a statement showing that this letter had been charged to the reserve account, and no objection was made, and indeed the Receiver treated the charge as proper until some time in May when a demand was made upon us for the amount of this letter. As soon as the demand was made, we notified the member banks concerned that if the contention of the Receiver was sustained, we would charge them with the amount of the checks which had been contained in this letter. Several of the member banks notified us that they would not stand the charge, but would litigate the question with us regardless of the result of the litigation between ourselves and the Receiver. I feel sure that if we undertook to charge them with the amounts of their checks in this letter they would litigate the question. Of course, we could accede to the demand of the Receiver and not charge our member banks, taking the loss ourselves, but even if we did this, I think the same question would arise in future cases, and with respect to the second letter of the Farmers & Merchants National Bank of Lake City.

The second letter was sent to the Farmers & Merchants National Bank of Lake City on October 8th, and the checks in it were charged to the accounts of the drawers on October 9th before the closing of the bank. This letter was in ordinary course chargeable to the failed bank on October 12th, but after charging the letter of October 7th, we had a balance amounting to only approximately $7,000.00, and the letter was approximately $20,000.00. We charged back the entire amount of the checks contained in this second letter and hold the balance in order that I might endeavor to decide as to whether or not it should be distributed as a part payment on account of the letter or not. Several member banks wrote to us asking for information as to the amount of the reserve balance. On being notified of the situation they claimed that the reserve balance should be applied to the cash letter, and notified us that they would hold us liable if we surrendered it to the Receiver. The amount of checks received from the banks which took this position is sufficient to justify them in the effort to test their rights, and if we abandoned our position in our controversy with the Receiver, I feel sure that some of these banks would endeavor to press the question to a settlement.

Since this question has been under discussion another member bank- that is to say the National Bank of Fayetteville has been closed. In the case of the latter bank there are two letters which were handled by it just before its failure, and which had not been actually charged to its reserve account on the day of the failure. We notified the member banks concerned that the Comptroller disputed our right to charge these cash letters to the reserve account, and that consequently we credited them with the amount of their checks upon the condition that if the Comptroller's position was sustained we would be compelled to charge back the amount of their checks.

If we acceded to the contention of the Receiver in the case of the Farmers & Merchants National Bank of Lake City we would be compelled to accede to it in the case of the National Bank of Fayetteville, and in all subsequent cases, and I feel reasonably certain that sooner or later a member bank would force a decision of the question.

In the Lake City case we had no rediscounts. In the Fayetteville case we have quite a large line of rediscounts, and if we undertook to charge back cash letters upon the ground that they were unpaid, and to apply the reserve balance to the rediscounts, it would create an impression that we are endeavoring to protect ourselves at the expense of member banks, and this attitude would, I think, create a most unfavorable impression upon the member banks. For the reasons stated, the officers of this bank and myself feel that we are almost compelled to settle the question which has been raised, but, of course, we would consider carefully any suggestions which other Federal Reserve Banks, or their Counsel wished to make. If you think that the matter is of sufficient importance to justify requesting the Counsel for other banks to meet for a conference, I should, of course, be delighted to have such a conference, but it seems to me that the question is scarcely broad enough to justify the trouble and expense which the conference would entail, and that perhaps it might be sufficient to send a copy of the statement of facts to each of the other Counsel and invite their criticism.

I am very glad to say that I am just back from a very enjoyable vacation at Virginia Beach, and I hope that you will soon be off upon yours, and will come back feeling as fresh as I do. I have never quite given up hope that you and Mrs. Wyatt will find your way to Richmond some day.

The time for applying the certiorari in the case of Craven Chemical Company v. Federal Reserve Bank of Richmond has expired, so I imagine that my opponents never thought of raising the jurisdictional question which we discussed in our former correspondence.

Very truly yours,

M.G. Wallace,
Counsel.

COPY

X-4976-f

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August 17, 1927.

Mr. M.G. Wallace, Counsel,
Federal Reserve Bank,
Richmond, Virginia.

My dear Mr. Wallace:

Referring to your letter of June 14th with regard to the claim made against your bank by the receiver of the Farmers and Merchants National Bank of Lake City, I enclose for your information a letter from Mr. Baker expressing his views as to the effect of such litigation on the test case we have been expecting on the legality of the action of certain Alabama banks in stamping their checks "not payable through the Federal Reserve Bank of Atlanta."

I disagree with Mr. Baker's views that your case is not one of System importance, because I fear that, in deciding the real matter at issue in your case, the Court is very likely to go so far as to say that a Federal reserve bank has no right under any circumstances to charge to the accounts of drawee banks checks which it does not own but which it is merely handling under Regulation J as the agent of the banks from which they were received. Such a ruling would be a serious blow to Regulation J and to the present check collection system, and I should regret very much to see it.

I have discussed with counsel of several of the other Federal reserve banks the questions involved in this case and all of those with whom I have discussed the question expressed serious doubt as to the right of a Federal reserve bank to charge to the account of an insolvent bank checks which are not owned absolutely by the Federal reserve bank itself. Heretofore I have refrained from expressing any views on this matter, but I now feel that I should tell you that I personally believe that the Comptroller's Office is right and that you are wrong in this particular controversy, and I fear that if you try a test suit you will lose it. The loss of such a suit would not disturb me very much, unless the Court should rule, or say by way of dictum, that the Federal reserve bank has no right under any circumstances to charge to the account of the drawee bank a check which it does not own in its own right but which it merely handles as the agent of another bank from which such check was received. In view of this danger, I sincerely hope that you will reconsider the advisability of trying such a test case and will advise me of your further views in the premises.

You will understand, of course, that this is merely an

expression of my own personal views and not the views of the Federal Reserve Board. Moreover, I hope you will understand very clearly that I have no desire to interfere with your handling of any litigation for the Federal Reserve Bank of Richmond. I merely suggest the danger pointed out above, in order that you may weigh the matter and reach a conclusion in your own mind as to whether it would be better for your bank to yield to the Comptroller of the Currency in this particular instance rather than to jeopardize the interests of the entire Federal Reserve System by going to suit on a doubtful question which may involve the legality of a very important provision of Regulation J. If you have any doubts about the matter, would it not be better to discuss this question at a conference of Counsel to all Federal reserve banks before testing such a question in the courts?

I sincerely hope that you have not been as busy as I have been this summer and that you have been able to take a little vacation. I am beginning to feel the need of one very badly and hope to go away from the office in a few days.

With all best wishes, I am,

Cordially yours,

Walter Wyatt,
General Counsel.

WW MD

COPY

X-4976-g

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BAKER, HOSTETLER & SIDLO
COUNSELLORS AT LAW
UNION TRUST BUILDING
CLEVELAND

June 18, 1927.

Dear Mr. Wyatt:

After several days of absence I return this morning and find your letter of June ninth, with the correspondence sent by Mr. M. G. Wallace of the Federal Reserve Bank of Richmond covering transactions with the Farmers and Merchants National Bank of Lake City.

In view of the fact that there does not seem to be a present means of raising our controversy in the Atlanta District, I am inclined to believe that Mr. Wallace should get up his test case as soon as he can and get the matter presented to a Federal Court for decision. Of course this does raise some question as to the right of Federal Reserve banks generally to make charges against the reserve balances of members, but it is a special case, and an adverse decision on the facts in these two instances would not necessarily conclude Federal Reserve banks from making charges against reserve balances of solvent banks or of banks as to which they had no notice of suspension.

In presenting this matter I hope Mr. Wallace will do whatever he can to narrow the issue to the facts of his case, so that the Court may not by inadvertence express an opinion which would be held to conclude the larger question. That is to say, if the fact of the bank's suspension and the notice of it should be held by the Court to terminate the right of the Federal Reserve bank to charge the reserve balance, I would be sorry to have the Court go on and express obiter any doubt as to the right to make such changes under other conditions.

In view of the facts of these cases I am inclined to agree with Mr. Wallace that this is not a system matter, particularly since the controversy is between the Federal Reserve bank and the Comptroller's office.

Cordially yours,
(Signed) Newton D. Baker

Mr. Walter Wyatt,
Office of the General Counsel,
Federal Reserve Bank,
Washington, D.C.

COPY

X-4976-h 245

FEDERAL RESERVE BANK OF RICHMOND

June 14, 1927.

Federal Reserve Board,
Washington, D.C.

Attention of Mr. Walter Wyatt, General Counsel.

Dear Sirs:

I have your letter of June 9th, and am very glad to know that you have forwarded to Mr. Baker copies of my letters relating to the claim made against this bank by the Receiver of the Farmers & Merchants National Bank of Lake City.

The Receiver and myself are endeavoring to agree upon a statement of facts hoping to avoid any unnecessary expense, or delay, in the settlement of this question. I have prepared a draft of such a statement and forwarded it to the Receiver for his consideration. I enclose you a copy thinking that Mr. Baker may desire to consider it, and to suggest changes in it, or additions to it. Naturally, I should welcome any suggestions from him, or from yourself.

I read with much interest the correspondence between the Federal Reserve Board and the Federal Reserve Bank of Atlanta, and your opinion upon the subject.

I remain,

Very truly yours,

(Signed) M.G.Wallace
Counsel.

MGW:IB

COPY X-4976-i 246

FEDERAL RESERVE BANK OF RICHMOND,
RICHMOND, VA.

Gentlemen:

The undersigned member bank hereby acknowledges receipt of Circular No. 143, of the Federal Reserve Bank of Richmond, regarding the "Collection of Checks," effective July 1, 1926, setting forth the terms and conditions under which cash items as specified in the circular will be received for collection from the undersigned member by the Federal Reserve Bank of Richmond or by another Federal reserve bank for its account, which circular supersedes Circular No. 131 of June 15, 1923.

Yours very truly,

Farmers & Merchants Nat Bank
Bank

Lake City, S. C.
Location

2/9/26
Date

By R. H. McElrcen
President or Cashier (Official Signature)

COPY

X-4976-j

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June 14, 1927.

STATEMENT OF FACTS

1. The Federal Reserve Bank of Richmond is and was at all times hereinafter mentioned a banking corporation, duly organized under the Federal Reserve Act, having its chief office in Richmond, Virginia, and the district, or territory, assigned to it included the State of South Carolina.

2. The Farmers & Merchants National Bank of Lake City was at all times herein mentioned a National banking association duly organized under the National Bank Act, and had its office in Lake City, South Carolina, until it was closed and placed in liquidation as stated herein.

3. The Federal Reserve Bank of Richmond had for sometime prior to the closing of the Farmers & Merchants National Bank of Lake City received on deposit, or for collection, from banks which were members of the Federal Reserve System and other Federal Reserve Banks, checks drawn upon the Farmers & Merchants National Bank of Lake City. All of the said checks were received in accordance with, and subject to the terms of Regulation J, series of 1924, duly made and promulgated by the Federal Reserve Board, a copy of which is hereto attached and made a part hereof, and with circular No. 143 issued by the Federal Reserve Bank of Richmond, a copy of which is hereto attached, and made a part hereof, and with the time schedule issued by the Federal Reserve Bank of Richmond, a copy of which is hereto attached and made a part hereof.

4. A copy of the said circular No. 143 had been sent to the Farmers & Merchants National Bank of Lake City, and receipt thereof had been acknowledged by the Farmers & Merchants National Bank of Lake City before the times hereinafter mentioned, a copy of which acknowledgment is hereto attached, and made a part hereof.

5. It had been the practice of the Federal Reserve Bank of Richmond to send on each business day to the Farmers & Merchants National Bank of Lake

City checks drawn upon it, which had been received by the Federal Reserve Bank of Richmond as above stated, and when three business days had elapsed after the dispatch of a letter containing such checks to charge the amount thereof to the reserve account maintained by the Farmers & Merchants National Bank of Lake City with the Federal Reserve Bank of Richmond. If the Farmers & Merchants National Bank of Lake City was willing to accept and pay such checks it retained them and charged them to the accounts of the drawers. If it was unwilling to pay any, or all of such checks, it returned such of them as it was unwilling to pay after causing them to be duly protested, if protest was requested, and the amount of all checks so returned was credited to the account of the Farmers & Merchants National Bank of Lake City.

6. In the course of conducting business, as stated above, the Federal Reserve Bank of Richmond did not disclose to the Farmers & Merchants National Bank of Lake City the names of persons from whom the checks had been received except insofar as this knowledge could be obtained from endorsements appearing upon the checks. The amount of all checks sent to the Farmers & Merchants National Bank of Lake City was charged by the Federal Reserve Bank of Richmond to it, in accordance with the practice above set out, and credited by the Farmers & Merchants National Bank of Lake City to the Federal Reserve Bank of Richmond as stated above, and all checks which were returned unpaid were returned by the Farmers & Merchants National Bank of Lake City to the Federal Reserve Bank of Richmond, and when received by the Federal Reserve Bank of Richmond were credited to the Farmers & Merchants National Bank of Lake City as above set out.

7. On Thursday, October 7, 1926, the Federal Reserve Bank of Richmond sent to the Farmers & Merchants National Bank of Lake City a letter containing checks drawn upon the latter amounting to $14,934.12. A copy of said letter is hereto attached. The said letter and checks were received by the Farm-

ers & Merchants National Bank of Lake City on October 8, 1926, and the slip or receipt attached to such letter was mailed by the Farmers & Merchants National Bank of Lake City to the Federal Reserve Bank of Richmond on October 8th. A copy of said slip, or receipt, is hereto attached. On October _____, 1926, the Farmers & Merchants National Bank cancelled checks contained in the said letter amounting to Fourteen Thousand Nine Hundred Dollars and Sixty-two Cents ($14,900.62), and charged them to the accounts of the drawers and returned unpaid checks amounting to Thirty-three Dollars and Fifty Cents ($33.50). On October 11, 1926, the Federal Reserve Bank of Richmond charged the reserve account of the Farmers & Merchants National Bank of Lake City with the amount of all checks contained in the above mentioned letter of October 7th, and on that day credited the amount of such checks to the banks from which they had been received for collection. Later checks, totalling Thirty-three Dollars and Fifty Cents ($33.50), which had been sent in the said letter were returned unpaid to the Federal Reserve Bank of Richmond, and the amount of such checks was credited to the Farmers & Merchants National Bank of Lake City and charged to the banks from which they had been received.

8. At the opening of business on October 11th the Federal Reserve Bank of Richmond had to the credit of the Farmers & Merchants National Bank of Lake City the sum of Twenty-two Thousand and Eighty-five Dollars and Fifty-two Cents ($22,085.52) and after charging the amount of the letter of October 7th and crediting the amount of certain checks, which were returned unpaid, there remained at the close of business on October 11th a balance in the reserve account of the Farmers & Merchants National Bank of Seven Thousand Two Hundred and Thirty-five Dollars and Six Cents ($7,235.06).

9. On Friday, the 8th day of October, 1926, the Federal Reserve Bank of Richmond sent to the Farmers & Merchants National Bank of Lake City a letter containing checks amounting to Twenty-one Thousand and Forty-one Dollars

and Two Cents ($21,041.02), a copy of which letter is hereto attached. This letter was received by the Farmers & Merchants National Bank of Lake City on the 9th day of October, 1926, and upon that day the Farmers & Merchants National Bank of Lake City returned to the Federal Reserve Bank of Richmond the slip, or receipt, a copy of which is hereto attached, and on the _____ day of October, 1926 cancelled and charged to the accounts of the drawers checks contained in the said letter amounting to Twenty Thousand, One Hundred and Seventy Dollars and Seventy-one Cents ($20,170.71) (were cancelled and charged to the accounts of the drawers thereof by the Farmers & Merchants National Bank of Lake City), and checks amounting to Eight Hundred and Seventy Dollars and Thirty-one Cents ($870.31) were returned as unpaid to the Federal Reserve Bank of Richmond.

10. On Tuesday, the 12th day of October, 1926, the Federal Reserve Bank of Richmond charged the amount of the checks contained in the letter of October 8th to the account of the Farmers & Merchants National Bank of Lake City, and later credited it with all checks contained in such letter which were returned unpaid. On October 12, 1926 there appeared to the credit of the Farmers & Merchants National Bank of Lake City in its reserve account on the books of the Federal Reserve Bank of Richmond a balance of Seven Thousand Two Hundred and Thirty-five Dollars and Six Cents ($7,235.06).

11. The Federal Reserve Bank of Richmond charged the full amount of each of the checks contained in its letter of October 8th back to the banks from which the same had been received for collection, and advised such banks that actual and final payment for such checks had not been received from the Farmers & Merchants National Bank of Lake City, and later the Federal Reserve Bank of Richmond notified such banks to which such checks had been charged that it was holding the sum of Seven Thousand One Hundred and Eighty-seven Dollars and Eighty-six Cents ($7,187.86), which appeared to the credit of the Farmers

& Merchants National Bank of Lake City in its reserve account, and that it would distribute the said sum as a part payment on account of the checks contained in the letter of October 8th if it appeared that such sum was applicable as a part payment on account of the checks contained in the letter of October 8th mentioned above. The said sum is still held by the Federal Reserve Bank of Richmond pending the determination of this case. The difference between the sum mentioned in this paragraph and the balance mentioned in the paragraph next preceding is due to certain entries properly made in the reserve account of the Farmers & Merchants National Bank of Lake City denoting proper charges and credits concerning matters not involved in this controversy.

12. On Saturday, October 9, 1926, after the close of business the directors of the Farmers & Merchants National Bank of Lake City resolved to close the bank, and on Sunday, October 10th, Mr. P. H. Arrowsmith, Attorney for the Farmers & Merchants National Bank of Lake City, sent to the Federal Reserve Bank of Richmond a telegram reading as follows:

"Farmers & Merchants National Lake City closed last night trying to reorganize Monday morning will you send us Garrett to help."

This telegram was received at the office of the Federal Reserve Bank of Richmond at about 11:30 A. M. Sunday, October 10th, and the contents thereof were immediately communicated to Mr. John T. Garrett, Manager of the Bank Relations Department of the Federal Reserve Bank of Richmond who left Richmond that night for Lake City, and arrived there on the morning of October 11th. The telegram was in the hands of the proper officers of the Federal Reserve Bank at the opening of business on October 11th. The Farmers & Merchants National Bank of Lake City was not reorganized, or reopened, and on the _____ day of _____, the Comptroller of the Currency appointed Thos. A. Early

as Receiver for the Farmers & Merchants National Bank of Lake City upon the ground that the bank was insolvent.

13. On _____, 1926, the Federal Reserve Bank of Richmond sent to the receiver a statement showing that it had transferred the balance of $7,187.86 mentioned above to a suspense account, and was holding the same, and the attached letters exchanged between the receiver and the Federal Reserve Bank of Richmond. On May 11th, 1927 the receiver for the first time demanded that the Federal Reserve Bank of Richmond pay over to him the amount charged to the reserve account of the Farmers & Merchants National Bank of Lake City on account of checks contained in the letter of October 7th.

14. The Farmers & Merchants National Bank of Lake City was a member of the Federal Reserve System and had subscribed for and been allotted 78 shares of the stock of the Federal Reserve Bank of Richmond, and had paid in on said subscription the sum of Thirty-nine Hundred Dollars ($3,900.00), and dividends at the rate of 6% from June 30, 1926 have accrued thereon and are unpaid. The Receiver has surrendered to the Federal Reserve Bank of Richmond the above mentioned stock, and has demanded the surrender value thereof.

15. Any party hereto may refer to, or rely upon, any regulation of the Federal Reserve Board duly promulgated at the times mentioned above, and all of such regulations so far as are in any way applicable to the above mentioned transactions shall be deemed a part of this stipulation.

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June 9, 1927.

Hon. Newton D. Baker,
Union Trust Building,
Cleveland, Ohio.

My dear Mr. Baker:

I enclose for your information copies of certain correspondence between this office and Mr. M. G. Wallace, Counsel for the Federal Reserve Bank of Richmond, regarding a dispute between that bank and the Receiver of the Farmers & Merchants National Bank of Lake City, which very likely will lead to litigation over the right of Federal reserve banks to charge checks to the reserve accounts of member banks after such member banks have been placed in the hands of receivers.

It occurs to me that this may open up the whole question of the right of Federal reserve banks to charge checks to the reserve accounts of member banks and that Mr. Wallace's litigation should either be postponed or should be coordinated with the litigation which may arise over member banks stamping their checks "Not payable through Federal reserve banks." I shall appreciate it very much indeed if you will kindly let me have your views about this matter.

With all best wishes, I am.

Cordially yours,

(Signed) Walter Wyatt,
General Counsel.

Enclosure:

COPY

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June 9, 1927.

Mr. M. G. Wallace, Counsel,
Federal Reserve Bank,
Richmond, Virginia.

My dear Mr. Wallace:

I have received your letter of May 25th with further reference to the controversy between the Federal Reserve Bank of Richmond and the Receiver of the Farmers & Merchants National Bank of Lake City and have read same with much interest.

As you probably know, the Federal Reserve System is now threatened with litigation over the question whether a member bank can defeat the purposes of the par clearance system by stamping on its checks the words "Not payable through Federal reserve banks"; and such litigation is very likely to involve the question whether the Federal reserve banks may lawfully charge checks to the reserve accounts of their member banks. In view of this situation, a court decision growing out of your controversy with the Comptroller of the Currency might affect the handling of this other and much more important question. I am, therefore, taking the liberty of forwarding a copy of your letters to Mr. Baker for his information and am requesting suggestions from him as to the proper coordination of your litigation with that in which he may be involved on behalf of the entire Federal Reserve System.

In order that you may know what this is all about, I enclose for your information copies of certain memoranda and correspondence with reference to member banks stamping their checks "Not payable through Federal reserve banks."

With all best wishes, I am,

Cordially yours,

(Signed) Walter Wyatt,
General Counsel.

Enclosure:

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255

FEDERAL RESERVE BANK
OF RICHMOND

May 25, 1927.

Federal Reserve Board,
Washington, D. C.

Attention of Mr. Walter Wyatt, General Counsel.

My dear Mr. Wyatt:

Under date of March 1st, I wrote you giving you the facts in a controversy, which has arisen between this bank and the Farmers & Merchants National Bank of Lake City.

The Comptroller of the Currency has raised another question in connection with this same bank. Under date of October 7th, we sent to the Farmers & Merchants National Bank of Lake City a letter containing checks aggregating $14,934.12. These checks were received by the member bank on October 8th, and receipt was duly acknowledged. The bank charged to the accounts of the drawers checks totalling $14,900.62 and returned checks totalling $33.50.

Under our time schedule, the amount of this letter was chargeable to the reserve account of the Farmers & Merchants National Bank on October 11th. On the night of Saturday, October 9th, the directors of the Farmers & Merchants National Bank being threatened with a run on the bank closed it, and notified us that they had closed it. This telegram was received on Sunday, October 10th. On Monday, October 11th, there appeared to the credit of the failed bank a sum exceeding the amount of the cash letter of October 7th, which was chargeable on October 11th. We accordingly charged the amount of this letter to the reserve account, and credited the member banks from whom the checks in the letter had been received. We have, of course, from time to time rendered statements to the Receiver showing that this charge was made. The Receiver did not protest against our action until recently when acting under the direction of the Comptroller of the Currency, he notified us that he would demand payment from us of the full amount of the reserve balance of the failed bank as it stood at the opening of business on October 11th. The Receiver contends that we could not charge a cash letter to the reserve account of the failed bank after receiving notice of its closing, even though the letter had been received, and the checks in the letter cancelled prior to the closing. We, have, of course, refused the Receiver's demand, and the Attorney for the Receiver and myself are endeavoring to make up an agreed statement of facts upon which this question and the other questions mentioned in my letter of March 1st may be submitted to the Federal courts for determination.

Yours very truly,
(signed) M. G. Wallace,
M. G. Wallace,
Counsel.

COPY

X-4976-n 256

April 7, 1927.

Mr. M. G. Wallace, Counsel,
Federal Reserve Bank,
Richmond, Virginia.

My dear Mr. Wallace:

I have received and should have acknowledged more promptly your letter of March 1st with reference to the right of a Federal reserve bank to charge to the account of an insolvent national bank the amount of cash letters forwarded to such bank but not paid before insolvency.

As suggested in your letter this office would desire to remain neutral on this question for the present at least since it is a controversy between the Comptroller of the Currency and the Federal Reserve Bank. I am very much interested, however, and appreciate your calling it to my attention. I shall also appreciate it if you will kindly keep me advised as to the further developments in this case.

With all best wishes, I am,

Cordially yours,

Walter Wyatt,
General Counsel.

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FEDERAL RESERVE BANK OF RICHMOND.

March 1, 1927.

Federal Reserve Board,
Washington, D.C.

Attention of Mr. Walter Wyatt, General Counsel.

My dear Mr. Wyatt:

Under date of October 8, 1926, this bank sent to the Farmers & Merchants National Bank of Lake City, South Carolina, a cash letter containing checks aggregating $20,170.71. These checks were received by the Farmers & Merchants National Bank of Lake City on the following day, and were cancelled and charged to the accounts of the drawers. Under our time schedule, the amount of this cash letter was normally chargeable to the reserve balance of the Farmers & Merchants National Bank of Lake City on October 11th, but on October 10th that bank was closed by order of the Comptroller of the Currency upon the ground that it was insolvent.

At the time of its closing, it had in our hands a net reserve balance of $7,187.86. We charged back the amount of the checks contained in our letter of October 8th to the several member banks from which they had been received, but at the same time we notified them, or some of them, that we were holding the reserve balance, which we thought was applicable as a part payment on the cash letter.

We filed our claim with the Receiver, but the office of the Comptroller of the Currency has held that we are not entitled to apply the reserve balance upon the cash letter.

I realize that your office would probably desire to be neutral in the case of a controversy between the Comptroller of the Currency, and a Federal Reserve Bank, especially as I believe, it involves, an interpretation of the Regulations, but I am writing you the facts in order that you may have them before you.

As you know, paragraph 4, section 5 of Regulation J reads in part as follows:

> "Checks received by a Federal reserve bank on its member or nonmember clearing banks will ordinarily be forwarded or presented direct to such banks, and such banks will be required to remit or pay therefor at par in cash or bank draft acceptable to the collecting Federal reserve bank, or at the option of such Federal reserve bank to authorize such Federal reserve bank to charge their reserve accounts or clearing accounts; provided, however, that any Federal reserve bank may reserve the right in its check collection circular to charge such items to the reserve account or clearing account of any such bank at any time when in any particular case the Federal reserve bank deems it necessary to do so."

We had issued our circular No. 143, which read in part as follows:

> "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time to and from the member bank. Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so."

The position taken by the Comptroller of the Currency is that the reserve balance is not a proper offset on the amount of the cash letter because with respect to the cash letter, we were acting as agents only, and the amount due upon it is due to the member banks, whereas the amount due to the failed bank on account of its reserve balance is due from us in our own right to the estate of the failed bank. I believe this position would have much strength if it were not for the provisions of the Regulations, and of the circular, but my position is that the Regulations, and the circular, operate as a contract between ourselves and the failed bank, and under this contract, the reserve balance was expressly applicable to payment for cash letters.

If the reserve balance had equalled, or exceed, the cash letter the mere fact that the bank had been closed by the Comptroller of the Currency before we had exercised our right to charge the amount of the cash letter against the reserve balance would not alter the fact that the amount of the cash letter was absolutely chargeable against the reserve balance, and if the amount of the cash letter was chargeable against the reserve balance, the fact that the reserve balance did not equal to the amount of the cash letter could not alter our right, or the rights of member banks. In other words, the Receiver standing in the shoes of the failed bank can take no advantage from the fact that the failed bank should have placed us in funds sufficient to cover the entire cash letter, and claim that we lose our right to a part because the failed bank did not place in our hands sufficient funds to discharge the whole obligation.

It seems to me that the position of the Comptroller of the Currency draws into question the right and duty of a Federal Reserve Bank in every case in which there is a failure of a member bank after the checks in a cash letter are cancelled, and before the elapse of the time allowed for remittance, or for charging the cash letter to the account of

the failing bank. It, therefore, seems to me that it is important that we reach some settlement, and I have advised the officers of the bank that I think we should frame a test case, and they have authorized me to notify the Comptroller of the Currency that we shall insist upon the application of the reserve balance, or, in any event, refuse to pay it over until the rights of the estate of the failed bank and of the member banks whose items were in the cash letter have been judiciously determined.

In view of the fact that the question is one which concerns primarily Federal Reserve Banks who do not employ the remittance system in dealing with member banks, the matter is probably not of sufficient importance to be called a "System matter", but as I stated above, I am reporting it to you in order that you may know what we are doing, and, of course, if you wish to give us any suggestions or advice, we should be delighted.

With best personal regards, I remain,

Very truly yours,

(SGD.) M. G. Wallace,
Counsel

MGW IB