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FEDERAL RESERVE BANK
of
Kansas City

March 24th
1 9 2 8.

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

My dear Mr. Wyatt:

I have your telegram requesting that I furnish you with my views concerning the proposed uniform bank collection code. I have assumed, although apparently erroneously, that the matter was of no particular urgency, and on account of the considerable time I have been absent from the office and the press of work while here, I have not previously attempted to go into it, as I otherwise would have done. This I regret exceedingly, especially since it appears that in waiting to hear from me you have experienced some delay and inconvenience in getting the work of the committee under way.

In going over the code I have not attempted to formulate suggestions as to changes or additions, which I believe is in accordance with the understanding had at our conference, but have endeavored only to find possible weaknesses in it. What I shall say accordingly shall be somewhat in the nature of a series of interrogatories concerning it.

Section 3.

In the first sentence of this section it is provided that a bank of deposit shall have the right to revoke any credit given for an item deposited before the close of banking hours on the day of deposit, if at the time of deposit the credit to the account of the drawer is insufficient for the payment of the item. In the next sentence it is provided that if sufficient funds are deposited or credited to the account during the same day the item shall be deemed paid at the time of such deposit or credit.

Queries:

1. Does not the first sentence afford all the protection that a bank of deposit requires in accepting items for deposit drawn upon itself?

2. Does the second sentence create a doubt as to its effect as against an attachment or garnishment of the drawers account levied subsequent to the time of the deposit of the item and prior to the time the account is made sufficient, and also does it create a doubt as to the effect of a stop-payment order given during the same interim?

The concluding part of this section is to the effect that a subsequent deposit or credit may not operate as payment of an item previously deposited if "at such time there is an existing indebtedness of such * drawer * the set-off of which would render such deposit or credit insufficient to pay such item.

Queries:

1. Is not the "existing indebtedness" referred to an indebtedness then due or one which may be then set-off, and if so is the recital entirely clear to that effect?

2. What reason is there for making payment contingent upon there being no existing indebtedness, where the account of the drawer is subsequently credited with funds sufficient to pay an item previously deposited, as provided in the last sentence of the section, and not making payment so contingent, where the account of the drawer is ample when the item is deposited, as provided in the first sentence of the section?

Section 6.

In this section there are prescribed "rules of ordinary care in forwarding and presentment".

Queries:

1. Rather than formulate rules which apparently attempt to embrace all acts, the performance of which constitute ordinary care, would it not be preferable to provide simply that collecting agents shall have the authority to do specifically named things? For instance, in subdivision (a) of this Section (Section 6) it is made the exercise of ordinary care to forward items by mail (1) direct to the drawee or payor bank, (2) to another bank collection agent. The right to use other means of transmitting the items than by mail, or to use an agent other than a bank, is not included within the rule of ordinary care that is stated. If the right were conferred as authority to do the things named, without prescribing a rule as to what constitutes ordinary care, the question

of whether other methods of handling would constitute ordinary care would doubtless not be affected, but where a rule of ordinary care in such transactions is prescribed, and the method followed is not within the terms of such rule, the effect of the rule in such a case is a question about which I believe there may be some considerable doubt.

The last clause in subdivision (a) of Section 6 provides that it shall not be deemed ordinary care to forward an item for collection to any bank as to which the forwarding bank has knowledge or reasonable ground to believe that it is not in a sound financial condition, and it is either insolvent or approaching insolvency.

Query:

Is this not a suggestion to contentious holders of items to charge collecting agents with knowledge of the condition of sub-agent banks? The rule which is stated is perhaps the law at this time, but it seems that a concrete statement of it in a statute would result in many unwarranted attempts being made to fix liability under its provisions. Witness the Malloy decision. I observe that the uniform statute which has been passed in many of the states authorizing items to be sent direct to drawee or payor banks confers the right to so handle items upon the condition that the "forwarding bank shall have used due diligence in other respects in connection with the collection of such instrument". Would not the same or similar language preserve to the owners of items the same right that they would have under the above provisions, and at the same time not cause unnecessary embarrasment and annoyance to collecting banks?

The latter part of sub-division (b) of Section 6 contains a provision somewhat similar to that in subdivision (a) which has just been referred to, and what has been said there applies likewise to this subsection.

In subdivision (c) of Section 6 it is provided that where an item is received by mail by the drawee or payor bank it shall be deemed the exercise of ordinary care to collect the item by charging the amount to the account of the drawer in the event the funds to his credit are sufficient, at the first reasonable opportunity.

Queries:

1. What purpose is served in prescribing a rule of ordinary care in this connection?

2. Why should any distinction be made between items received by mail and those deposited by a customer of the drawee bank (Section 3) as to when the items are paid?

3. Should there be a time fixed within which items must be charged by the drawee bank or returned?

It is also provided in subdivision (c) of Section 6 that items first received in the mails shall be charged to the account of the drawer in preference to items later presented or received.

Queries:

1. Does that not place an impracticable duty on the drawee bank in actual operation?

2. Would it prevent items of smaller amounts being charged to the account of the drawer if no additional credits were made to his account and the account were sufficient to pay the smaller items?

Section 8.

With reference to the duty to make inquiry concerning an item for which returns have not been received, within what time must such inquiry be made, and what constitutes "proper inquiry"?

Section 9.

The last sentence of this section refers to the duty of a collecting agent which has knowledge of the approaching insolvency of a drawee bank, or reasonable ground to suspect that it is about to close its doors. The same inquiry is made concerning this provision as has been made concerning similar provisions in subdivisions (a) and (b) of Section 6.

Section 11.

At the commencement of this section it is provided that items which come within the terms of Section 188 of the Negotiable Instruments Act are excepted. Should not an exception also be made as to items which come within the terms of Section 186 of the Negotiable Instruments Act?

The continued liability of the drawer of an item is made dependent not only on condition that "(1) ordinary care has been exercised in forwarding such item to the drawee or payor" but also "(2) in case of an agent presenting such item directly to the drawee or payor there has been no opportunity offered such agent to obtain money or a solvent credit".

Query:

Would not the second condition operate to release the drawer in most all instances where the bank presenting the item and the drawee bank are located in the same place, for what circumstances in such a case other than insufficient money on hand to pay, or lack of a solvent credit in the requisite amount, would constitute a failure of "opportunity" to collect in money or a solvent credit?

In the last sentence of this section a partial release of drawers of items is provided for where the bank or banks presenting the items exchanged the same for items against itself or themselves and the draft of the drawee bank.

Queries:

1. Is this plan workable where clearings are made through a clearing house in which settlements are made between all clearing member banks upon net balances due, and without reference to particular items of credits or debits against individual banks?

2. Would not a proportionate release result in uncertainities, confusion, and controversies?

3. If workable, would not the drawers of items presented by collecting agents against which the drawee bank held items for collection, obtain an advantage over drawers whose items are forwarded by mail for collection, without good reason for such advantage?

4. Could not equality of rights be maintained as between all holders by charging back all items, and as to items received from other banks for which in part items against such other banks were exchanged, require such banks to pay the amount of such items in cash?

5. What effect does charging the items to the account of the drawers have on endorsers and parties secondarily liable?

6. If it is contemplated that endorsers or parties secondarily liable shall be released, is this entirely fair to the owners of items, particularly where such items are accepted on the credit of such persons?

Section 12.

By this section it is made the duty of the receiver or other officer in charge of the assets of a failed bank to return to the presentor thereof all items which are not actually paid for. What provision, if any, should there be as to items which have been returned to the drawers prior to the closing of the bank?

Section 13.

Subdivision (a) of this section provides that upon the closing of a bank preference shall not be given for a draft issued for an item "drawn upon, payable by, or at" such bank.

> Query: Is not this provision too broad? Would it not wrongfully deny a preference in instances where an actual fund came into possession of the bank for payment of an item? For instance, if the maker of a note payable at a bank paid the amount thereof to the bank in cash immediately prior to its closing, would not the owner of the note be rightfully entitled to recover the funds as a preference. The provision, as drafted, however, would appear to deny him this right.

In subdivision (b) of paragraph 13 a preference is provided for as to items which a bank has collected from another bank. The manner in which the collection has been effected from the other bank is not stated.

> Query: Should not the right to preference be dependent upon the existence of trust funds, whether or not the same have become mingled with assets of the bank and some method of relief be provided for the owners of items collected by an insolvent bank, other than at the expense of the depositors and creditors of the failed bank?

I find that I have been more prolix than I had expected, but I trust there may be something in what I have said that may be of value.

Very cordially yours,

(S) H. G. Leedy.

HGL-L

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HERRICK, SMITH, DONALD & FARLEY

First National Building
1 Federal Street

Boston March 22, 1928.

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

Dear Mr. Wyatt:

At the last conference of counsel of the Federal reserve banks there was submitted in draft form Mr. Paton's proposed "Uniform Bank Collection Code." As there was no opportunity to discuss this in detail at the conference, the matter was referred to a sub-committee and all counsel of the reserve banks were invited to send in their comments.

When we returned from Washington, Mr. Carrick took under consideration the experience of the Federal Reserve Bank of Boston in the matter of collections. He also obtained from Mr. Agnew a copy of his letter to Mr. Paton dated December 23 last, in which Mr. Agnew analyzed the code. Mr. Carrick and I have just had an opportunity to go over this matter and here are my comments for what they are worth.

We have never had a single case in court growing out of the collection of checks or other items. Mr. Carrick tells me that there has never been any collection case involving any loss to the Reserve Bank of Boston except in connection with one small item where we misrouted a check and paid up the loss as soon as our negligence became apparent.

Thus, at least so far as our practical experience is concerned, there is nothing in existing conditions to indicate the necessity of formulating any code. Perhaps your committee will take under advisement as to whether a new code is necessary. I think it might be borne in mind that all new legislation, however carefully prepared, turns out almost inevitably to be defective or ambiguous in some respect.

Now as to the code itself, I won't even pretend to analyze the provisions in any comprehensive manner. I will merely call your attention to the following points.

In the first place in the course of my private practice I have had quite a bit to do with branch banking. Mr. Paton defines a "branch" as a "bank". Under his definition is a bank with a branch the equivalent of two banks? Is a check drawn generally on a bank payable at a branch, and conversely is a check made payable at a branch payable at the main office of a bank? I don't think the proposed code is clear on the point.

Again the question of setoff where a bank holds an unmatured note of a depositor and the depositor becomes insolvent is important, particularly where the bank desires to exercise its rights prior to actual receivership or bankruptcy. I don't know that this is a proper subject for the code, but it might be suggested to Mr. Paton as a question to be considered.

In Massachusetts we have a decision (Castaline vs. National City Bank of Chelsea, 249 Mass. 192) holding that where two checks are presented

at the same time and the bank is able to pay one but not both, the Bank owes a duty to pay one. The proposed code is not clear as to the duty of the bank where a number of checks are presented at the same time.

So far as Mr. Agnew's suggestions are concerned, it seems to me that most of his points are well taken. I am particularly impressed by his comments relative to "solvent credits" and relative to responsibility where there is knowledge or reasonable grounds to believe that a bank is insolvent or approaching insolvency.

I trust that the above few points may be of some help to you.

Very truly yours,

(Signed) A. H. Weed.

AHW:M
CC-Mr. Carrick.

SQUIRE, SANDERS & DEMPSEY

Counsellors at Law

The Union Trust Building,

Cleveland

March 21, 1928.

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

Dear Sir:

We regret that it was not possible to mail this letter to you last night in time to reach you in Washington today, and accordingly we wired you this morning advising that our comments on the Uniform Bank Collection Code would not reach you until tomorrow.

The following suggestions have occurred to us in reviewing the draft of the proposed Code prepared by Mr. Paton:

Section 1. Definitions.

Subdivision (a). The concluding sentence should, we think, be changed to read: "A branch of any such institution shall be deemed a bank for the purpose of this act."

Subdivision (b). We do not believe there is a necessity to define the term "Solvent credit" in the Code for the reason that we later express the opinion that the portions thereof in which the term "Solvent credit" is used should be eliminated from the proposed Code.

Section 2. Bank of deposit is agent for collection. Omit in line 3 the words "payee or other" for the reason that they are superfluous.

Section 3. Item on same bank. This Section should, we think, be revised to read as follows:

"Where a bank receives on deposit for credit to the depositor, an item drawn upon it or payable by or at such bank, such item shall be deemed paid at the time of its receipt if at such time there are funds to the credit of the drawer or maker thereof sufficient for its payment after deduction therefrom of any amount as to which such bank has a right of set-off, If at the time of receipt of any such item, such funds are insufficient to pay same and subsequently during the same day sufficient funds are deposited or credited to the account of the drawer, such item shall be deemed paid at the time of such deposit or credit unless at such time such bank has a right of seteff which would render such deposit or credit insufficient to pay such item."

The principal change suggested in the revision of Section 3 is to clarify the provision that payment shall be deemed to be made only in the event at the time the item is received, funds are available for payment exclusive of such amount as may be subject to the right of set-off by the depositor bank. In the original draft specific reference is made to the right of set-off in the concluding portion of the paragraph, but no reservation of this right is made to the bank in the initial portion of the section. Obviously, the funds available for payment should be subject to diminution by the depositor bank's right of set-off upon the receipt of the item, and it seems to us that this reservation should be clearly made in the language of the section.

Section 5. Duty and responsibility of bank collection agents.

It seems to us that this caption should read: "Duty and responsibility of bank collecting agents." The text of this section should, it seems to us, be changed to read:

It shall be the duty of the initial or any subsequent bank collecting agent to exercise ordinary care in the collection of an item and when such duty is performed, such agent bank shall not be responsible if, for any cause, the instrument is not collected. An initial or subsequent bank collecting agent shall be liable for the neglect, misconduct, mistakes,

or defaults of any other agent bank. The drawee or payer shall be deemed a collecting agent of the owner or holder for the purpose of collecting an item from itself, other than a deposited item".

"Bank collecting agent" has been substituted for "Agent collection bank" and for "Agent collecting bank",

Sections 6, 7 and 8. It does not seem to us that the provision of a uniform bank collection code can safely go farther than the provisions of Section 5 in attempting to fix the duty of collecting agents. We believe, therefore, that the provisions of Sections 6, 7, and 8 should be omitted.

The attempt in subdivision (a) of Section 6 to provide what does not constitute ordinary care in forwarding an item for collection to any bank, is dangerous. It is believed that conditions under which items may be properly forwarded are not susceptible of definition and that if the language of this subdivision were enacted as law, the result would be to encourage claims against banks on the ground that the knowledge existed or should have existed that the bank to which the item was forwarded, was not in a sound, financial condition.

In the Federal Reserve System it is frequently true, we understand, that banks are used as collecting agents which are not regarded by the officers of the Federal Reserve Bank of the district as being in a sound, financial condition. In the last analysis, the question of whether a bank is a proper collecting agent is dependent upon so many facts in each particular case that we do not think an attempt should be made by statute to prescribe the conditions which make a bank a proper collecting agent.

Sub-division (b) of Section 6 does not seem to us to add anything to the common law liability of a collecting agent.

Subdivision (c) lacks the reservation of the right to protect the drawee or payor bank on its claims against the drawer of the check recited in Section 3 of the draft. It seems to us that this sub-division should at least be revised to contain the same reservation of right to the drawee or payor bank contained in Section 3, and preferably it should be omitted entirely.

Section 7 seems to us wholly superfluous and unnecessary because the rule prescribed is, we believe, the rule by which the collecting bank would be bound regardless of statute.

Section 8 seems to us to be superfluous and unnecessary because it prescribes a rule of diligence which, we believe, is imposed by common law.

Section 9 seems to us to be an illadvised attempt to prescribe by statute the right to accept payment in a form other than money which is best covered by agreement between the depositor and the depository bank. We do not think it advisable that the statute should attempt to define what constitutes ordinary care for the reasons stated supra. We believe this section should be omitted entirely.

Section 10. Collection of paper taken in payment. This section seems to us to be superfluous and unnecessary. The obligation of using ordinary care obviously applies as to acts done with regard to any purported payment received for items which a bank is attempting to collect.

Inasmuch as we feel that the provisions of Sections 6, 7, and 8 should be eliminated, we do not believe there is any purpose in including Section 10 which relates back to the sections mentioned above covering the standards of care required.

Section 11. Continued liability of drawer. The first portion of this section ending with the words "there has been no opportunity offered such agent to obtain payment in money or a solvent credit" seems to us to be unsound. It is our theory that if an item has been received payable by or at a bank and if the account of the drawer thereof has been charged therewith prior to the closing of the drawee or payor bank, this act on the bank's part should constitute an appropriation of its assets to the payment of the item and the claim should be given preference in accordance with the suggestions hereinafter made with regard to Section 13. The drawer's liability in such event should only be in case the claim so given priority fails to liquidate the drawer's indebtedness to the owner of the item, and then only to the extent of such deficit.

We think the concluding portion of Section 11 commencing "Where the draft of a drawee or payor bank, etc." should be omitted. It seems to us that if a member of aClearing House Association gives its draft in purported payment of a debit balance against it, any loss resulting from the uncollectibility of this draft should not fall upon the drawers or makers of the items received by the drawee bank at clearing.

Section 12. Duty of receiver. We think that this section should be changed to read as follows:

> "It shall be the duty of the receiver or other official in charge of the assets of an insolvent bank, to return to the presentor thereof all items drawn upon or payable by or at such insolvent bank which have not been charged to the respective accounts of the drawers or makers thereof with such insolvent bank prior to the closing thereof."

Our view is that the charging of a check or draft to the account of the drawer thereof on the books of a bank constitutes an appropriation of the bank's assets to the payment of such an item and that if this has been done prior to the closing of the insolvent bank, the claim should be given priority over the claims of general creditors of the bank.

Section 13. Preference in case of insolvency. We believe that subdivision (a) of this section should be changed to read: "In case of an item drawn upon or payable by or at a bank, for which the draft of the drawee or payor has been given but not paid because of its insolvency, the owner of such draft shall be entitled to preference in payment from the assets of the failed bank in preference to all general creditors thereof."

Section 14. Lien of collecting bank. The first sentence in this section should, in our opinion, be revised to read as follows:

> "A depository bank shall have a lien on all items deposited with it for all indebtedness of the depositor thereof, except in case where it appears from the item that the depositor is not the owner."

The concluding portion of this section commencing "A subsequent collecting bank" should, in our opinion, be eliminated. The cases where a subsequent collecting bank can have a lien even under the provisions of this portion of Section 14, are so unusual as not to merit provision therefor in a statute, because substantially all items which are received for collection bear restrictive endorsements.

We regret that owing to the fact that the writer has been away from Cleveland most of the time since the conference of counsel it has not been possible to prepare these comments upon the Uniform Bank Collection

Code more promptly.

For your convenience, we are enclosing two extra copies of this letter.

Yours very truly,

SN:RG (Signed) Squire, Sanders & Dempsey
-enc-

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UELAND & UELAND
401 New York Life Building
Minneapolis

March 21, 1928.

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

Dear Mr. Wyatt:-

We have your wire concerning our comments on the Uniform Bank Collection Code of which we have a tentative draft prepared by Mr. Thomas Paton, General Counsel of the American Bankers' Association. This draft undoubtedly represents an able attempt to codify the law with respect to bank collections. We will give our criticisms dealing with the various sections of the draft in their order.

Section 1 (b) - Query as to the use of the word "solvent" before the word "bank" in this subdivision. If the credit is requested or accepted by the collecting bank it would seem that such a credit ought to be considered final payment whether the bank giving the credit were in fact solvent or not. In fact we question the use of the term "solvent credit" throughout the entire draft. "Authorized credit" would seem better.

Section 2 - Query as to the use of the word "negotiable" in the first line. This prevents the code from being applicable to many instruments which should probably be included. As we all know a large number of items are handled by banks as cash items which for some reason or other would not be negotiable within the meaning of the Negotiable Instruments Law.

Section 3 - In Minnesota the words "or payable by or at such bank of deposit" in the second line of the section would have to be omitted. This is

because our Negotiable Instruments Law provides that the fact that an instrument is made payable at a bank "shall not be" equivalent to an order to the bank to pay the instrument. Sec. 7130 Minn. G. S. 1923. It seems to us that this section imposes too severe a burden on the bank of deposit. If A deposits the check of B for $100.00 on the same bank, the credit given is irrevocable if B at that precise moment of time has a $100.00 balance. As a matter of actual banking practice the check will not be charged to B's account until later in the day. In the meantime B may have drawn out his $100.00 balance. It seems to us that Section 3 should be revised so as to reserve to the bank of deposit the right to charge back such checks "if not found good at the close of business on the date credited".

Section 4 - In respect to this section and also section 11 we question the advisability of enacting legislation which in effect repeals or modifies any part of the Uniform Negotiable Instruments Law. To us it would appear more statesmanlike to attempt to amend the Uniform Negotiable Instruments Law.

We question the use of the words "in blank or in full" in the 9th and 13th lines of this section. The words "by unrestrictive endorsement" should be substituted.

Section 5 - It is not expressly stated that any intermediate bank in the chain of collection is the agent of the owner of the item. This should be made express so as to settle the question whether the owner of the paper can maintain a suit against the intermediate collecting bank.

We suggest that the words "or holder" in the next to the last line of this section be taken out.

Section 6 - We suggest that the proviso at the end of paragraph (a) be struck out and that there be substituted in lieu thereof a proviso to the effect that it shall not be deemed ordinary care to forward an item for collection to any bank as to which the forwarding bank has knowledge that it is unable or is failing to meet its obligations as they mature, or is unable or is failing to handle properly items sent to it for collection. The proviso in its present form seems objectionable to us as encouraging litigation. The words "reasonable ground to believe" enable the plaintiff in many cases to make the collecting bank's negligence a question for the jury with the usual result. Under the proposed legislation direct forwarding would become the normal procedure and the banks ought not to be held liable for following that procedure except in cases where they have definite knowledge that the drawee bank is in bad shape or where they have specific instructions not to forward direct.

Paragraph (c) of Section 6 seems objectionable as imposing too severe a burden on the drawee bank. As a practical matter we have doubt as to whether it would be possible for the drawee bank to charge items received in the mails to the drawer's account in preference to items later presented or received.

Section 8 - It seems to us that this section imposes too severe a standard of care upon the forwarding bank. In the case of the Federal Reserve Bank of Minneapolis remittances are delayed in so many cases that it would be almost impossible to trace immediately all letters as to which remittances are not received "in due course of mail". To follow this procedure would also result in a great deal of confusion. About the best the Federal

Reserve Bank could do would be to send out tracers at the end of the second day after the expiration of the period when returns should have been received. We think Section 8 should be made more moderate as far as the collecting bank is concerned.

Section 9 - Query whether the collecting bank should be permitted to accept in payment a draft drawn on a point distant from the location of the collecting bank. It seems to us that such a permission may encourage careless banking.

Section 12 - This section should not require the return of the items to the presenting bank unless the draft given to the presenting bank is returned.

Section 13 - We believe this section should be omitted altogether. The question of preferred claims is so intricate that we believe Section 13 would add to the confusion rather than simplify matters.

Section 14 - The last clause reading "but such lien may be acquired upon any such item or its proceeds for an indebtedness of the real owner thereof" ought to be omitted. On principle a collecting bank should not have a lien upon items coming into its possession without the consent of its debtor.

In Minnesota there is not the same necessity for the adoption of a uniform bank code as there may be in other states. Chapter 138, Session Laws 1927, while imperfect in many respects, at least has the merit of being short and readily understandable. We are inclined to believe that if a uniform statute is to be agreed upon, such statute should be a simple statement of the Massachusetts rule plus a provision for sending items direct and receiving

drafts in payment. The other matters attempted to be covered by the proposed code we would be willing to leave to judicial decision.

Yours very truly,

(S) A.Ueland.

(S) Sigurd Ueland.

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FEDERAL RESERVE BANK

of Atlanta.

March 20, 1928.

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

Dear Mr. Wyatt:

Criticism of the Uniform Bank Collection Code, as tentatively drafted by Mr. Thomas B. Paton, General Counsel to the American Bankers' Association, has been delayed by reason of absences from Atlanta and court engagements of the writer.

We have now reviewed the proposed draft and submit herein certain comments concerning the same.

We might remark at the outset that we rather doubt both the feasibility and advisability of securing the enactment of anything which might properly be termed a Uniform Collection Code. We believe that it would be very helpful were the several States to enact legislation designed to accomplish certain specific things, namely: (a) the right to send checks direct to drawee or payor banks; (b) the right to accept bank drafts in lieu of cash; (c) exemption from liability on account of the default or omissions of subagents; and (d) the clarification of the law on the subject of preferences in insolvent bank liquidation. We believe, however, that it would be better to limit the activities of the Association to the accomplishment of these particular ends rather than to attempt to have enacted a somewhat ambitious code which runs counter to the common law in a number of respects, and which experience might demonstrate to be defective if not dangerous.

We point out several provisions of the proposed Act which might react unfavorably upon banks, for whose protection the same were framed.

For example, Section 2 of the proposed Act provides that in all cases where there is no express agreement to the contrary a bank, receiving a check on initial deposit is to be regarded merely as the agent of the depositor. Undoubtedly a bank should, as most banks do, enter into an agreement with its own depositors of substantially the same legal tenor as Section 2; but we doubt the wisdom of a statute which would, by law, establish a contractual status of the kind, since such statute might affect the rights of third per-

sons, whereas the latter would not be charged with notice of the private arrangement existing between such bank and its depositors. One of the complications which might result from an enactment of Section 2 is recognized in Section 4, in which last mentioned Section it was thought necessary to provide, in order to protect third persons, for a presumption of ownership in the bank of deposit of items to be collected, although the provisions of Section 2 are directly contrary to the presumption set up in Section 4.

This particular question is of importance to the Federal Reserve Banks since Regulation J establishes, with respect to the collection of checks, an agency relation only as between the Reserve Banks and the banks from which the items are received. We recognize the fact that Regulation J would doubtless create and preserve a contractual status which would not be affected by the enactments of a State; but it seems to us that it would be better, from the standpoint of the Federal Reserve Collection System, were Section 2 omitted from the proposed Act, leaving the relationship between a bank and its depositors to be governed by the law as it now exists or by private contract.

The decisions of the courts have pretty well established the relation between a bank and its depositors and, while there is a conflict in the different jurisdictions, we believe that a statutory declaration or definition of this relationship might lead to consequences not fully anticipated. The question of an agent's authority is always fraught with danger to one dealing with an agent. At the present time bankers quite generally treat items forwarded to them by other banks as being subject to the control, disposition and direction of the forwarding bank and neither look for advice to, nor seek the direction of, the actual owner of the item who would, under the statute, be the principal acting through an agent, whose authority the Act does not purport to define. This is true whether such items are endorsed in full, in blank or "for deposit." It would be unfortunate, it seems to us, for a statute to put the world on notice that anyone taking an item for collection or payment from a forwarding bank is dealing only with an agent of uncertain authority, and the resulting situation would be aggravated by Section 4 of the Act, which undertakes to distinguish the several kinds of endorsements. Under the terms of the last mentioned Section, there is no "presumption" of ownership in the forwarding bank except in cases where there is an endorsement "in blank or in full." Assuming the right of the recipient of a check so forwarded to rely upon the presumption of ownership, despite the inconsistent provisions of Section 2, there would still be no certainty of protection in taking instructions, at least of any unusual kind, from a bank that had originally taken the item endorsed merely "for deposit." In the ordinary case of routine collections the agent might, in any event, be presumed to have sufficient authority to instruct with regard to the collection,

but there would, undoubtedly, develop cases of an unusual nature in which specific instructions would have to be asked of someone. In such unusual cases the forwarding bank as "an agent for collection and not owner of the item" might perhaps not be authorized to give such special instructions, because the same might lie outside of the scope of the agency. The question would be very doubtful in the case of an instrument originally endorsed merely "for deposit".

Section 3 and Subsection (c) of Section 6, as now framed, would, we believe, entail complications as well as dangers in paying checks. No provision is made in either Section to cover the situation which would arise where several checks of the same maker are received on deposit or through the mails during the same banking day and the maker's account is insufficient at the close of the banking day to pay all of such checks. It would be practically impossible for a bank to fix and determine the exact times when separate checks are received on deposit for credit to different payees or other depositors; however, Section 3 provides, in effect, that in the event an account, insufficient at the time deposits are made, is replenished during the same day, items received on deposit "shall be deemed paid at the time of such deposit or credit." Suppose, for example, A deposited a check of B for credit at 9:00 in the morning. At that time the account of B was insufficient to pay the same. At 11:00 in the morning C deposited a check of B. Before the close of business B deposited funds sufficient to justify the payment of either, but not both checks. Under the provisions of Section 3 it would doubtless be the duty of the drawee bank to allow to stand the credit which had been given to A and to revoke the credit which had been given to C. This might be the rule even in the absence of a statute but, generally speaking, it is not feasible to take into account fractions of a day, and the mandatory requirements of the statute would only increase the difficulties under which banks now labor. Subsection (c) of Section 6 would make it encumbent on all banks to take strict account of the actual time of receipt through the mails of every item, and, while this could be done, the chances of loss, due to the failure on the part of a clerk to note the actual time of the receipt of a letter, would be largely increased. In the event a number of items, drawn by the same maker, were received through the mails during the same day a list might have to be made up showing the exact order of receipt and, in the event of a deposit before the close of business, the items would have to be charged to the account of the maker in the order of receipt. In many cases there might arise disputes as to the time of actual receipt and the burden would be upon the bank to explain delays in mails and the like. We recognize, as above stated, that the same questions now perplex bankers and add to the joys of doing business: it seems, however, that no good would be accomplished by statutory provisions which, in terms, impose duties and responsibilities as to priorities and preferences in the payment of items which cannot all be satisfied.

Section 3 places in the same category items drawn upon, payable by or payable at a bank. Obviously, the Section, as drawn, would not be appropriate

for enactment in those States where Section 87 of the Negotiable Instruments Act has not been enacted, or is of a tenor different from that of the "Uniform" Act. In Georgia, for example, the section reads "Where the instrument is made payable at a bank, it is not equivalent to an order to the bank", etc.

If the Code is to be enacted for the legitimate protection of banks, there would seem to be no purpose in inserting in Section 6 the provision that it shall not be ordinary care to forward an item for collection to any bank as to which the forwarding bank has knowledge or reasonable grounds to believe that it is not in a sound financial condition, etc. This provision is, doubtless, merely declaratory of the common law, but to state and restate a liability which would exist independently of the statute would seem to be out of place in a Code which is designed to protect the banking business. This is particularly true inasmuch as the effect of the same might probably be to invite suits, even in cases where the forwarding bank was doing its best under all the circumstances, as, for example, where there was but one bank in the town.

We do not like Subsection (b) of Section 6 for the further reason that it undertakes to make provision, in the event of suspected insolvency, for the obtaining of payment in money or a "solvent credit." After a check has been forwarded to a bank there is usually little that the forwarding bank can do to secure payment if the payee bank is, in fact, insolvent or approaching insolvency. If there was no knowledge of bad conditions when the check was forwarded, the forwarding bank ought not to be subjected to the burden of taking extraordinary steps to secure its payment. It is, furthermore, difficult to see how a bank in extremis would be in a position to furnish to its correspondent a "solvent credit" as defined in the Act, much less actual cash.

Section 6 by implication and Section 9 by express language make negligent the acceptance of a bank draft from a bank in bad circumstances unless the forwarding bank has taken any and all steps which a prudent owner of the item would take to obtain payment in money or a solvent credit. We do not think that the forwarding bank ought to be burdened with such requirements of diligence for reasons which are above stated.

Section 13 embodies an excellent idea and contains provisions which we would like very much to see enacted generally into law.

It is likely that the Federal Reserve Banks, as such, should not oppose the enactment of the suggested Code even though, obviously, any bad effects which might follow the same would be felt the more keenly by the Reserve Banks because of their widespread collection functions and the tremendous volume of the same. It may be that our views as to the proposed Code are somewhat colored by the fact that the Reserve Banks are usually gratuitous agents for collection, doing business at a heavy expense and constantly being

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called to account for alleged negligence where none in fact exists. It may be true that some of the criticisms herein set out are not well-founded. It is our opinion, however, that the Code, at least in its present form, should not be enacted, and, as above stated, we are inclined to doubt the advisability of the effort which is being made to secure this legislation.

The important points for legislation summarized at the beginning of this letter could, we think, be covered very much more simply and without the danger, actual or potential, which we believe would be inherent in the enactment of Mr. Paton's "Code".

Very truly yours,

RANDOLPH & PARKER.

By Robt. S. Parker.
General Counsel.

RSP/w.

Copy X-6085-e

FEDERAL RESERVE BANK OF CHICAGO

Chicago March 17, 1928.

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

Dear Sir: Re: Uniform Bank Collection Code.

I must apologize to you for my seeming neglect in failing to write you at an earlier date my view on the proposed Uniform Collection Code which was on the program as Topic 11 at the conference of counsel of Federal Reserve Banks at Washington, on February 9th,-11th, 1928.

The facts are, that until today I have been unable to give the matter any attention by reason of absence from the office of several of my associates; and even now I have been able to give the matter but a very casual study.

In Sec. 2, occur the words "Until it has received the proceeds"; and it seems to me that the language there contained needs to be clarified. Which bank is "it" in the language quoted?

In Sec. 4, occurs the language, "An endorsement 'pay any bank or banker' shall be deemed a restrictive endorsement". This runs counter to the holdings of many of the courts and I doubt the propriety of attempting to codify the law in that respect. I think the general rule is that such endorsement is not restrictive.

In paragraphs (a) and (b) of Sec. 6, there seems to be an attempt to define what is "ordinary care" by saying what is not ordinary care. These paragraphs, if adopted, would throw a very heavy burden on Federal Reserve Banks, and I doubt the propriety of such language being inserted in the proposed Code.

In Sec. 8 there is language that requires an agent for collection to make immediate inquiry if he does not receive advice in "due course of mail". The language is not clear and it seems likely that a strict construction thereof might place too much responsibility on the collecting bank, in the matter of due care; and as in the other sections above referred to, it singles out a particular thing which shall not be due care.

In Sec. 12, there is an attempt to place a duty on a receiver which he probably could not carry out.

I doubt the soundness of the rule suggested in paragraph (a) of Sec. 13 and I would not like to see such rule adopted.

I am very sure that my comments here can be of little help in considering this matter, but I send them along for what they are worth.

With kind regards,

Yours very truly,

(S) CHAS. L. POWELL,
Counsel.

CLP

Copy

X-6085-f

Law Office Of
LOCKE, LOCKE, STROUD & RANDOLPH,
American Exchange Building
DALLAS, TEXAS.

March 16th 1928.

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

Gentlemen:

We enclose herewith criticism of the first tentative draft of Uniform Bank Collection Code prepared by Thomas B. Paton, Jr., General Counsel of the American Bankers Association.

Yours very truly,

(S) Locke, Locke, Stroud & Randolph.

EBS-s
encl:

Copy X-6085-f

CRITICISM
of
First Tentative Draft of
Uniform Bank Collection Code
prepared by Thomas B. Paton,
Jr., General Counsel of the
American Bankers Association.

- -o-

Section 1. Definitions.

(a) Bank. This definition is broad enough, of course, to include Federal Reserve Banks.

(b) Solvent Credit. The definition of "solvent credit" set out in this sub-paragraph is, in our opinion, inadequate and would give rise to much litigation and uncertainty. This is an important matter in view of the fact that "solvent credit" is used throughout the proposed code. The greatest uncertainty of the definition comes about because of (1) the use of the words "solvent bank" and (2) the use of the words "requested or accepted". The question of whether or not a bank was at any time solvent is always a question of fact and it would follow that where a bank had failed the exact time of its insolvency would be difficult to ascertain, if not wholly impossible, except by a jury's guess, and therefore under the definition used there would always exist a question of fact as to whether or not there was a solvent credit.

The words "requested and accepted" give rise to doubt, particularly the word "accepted". As to whether or not a credit had been requested or accepted would be a question of fact arising in every case and always difficult of determination.

Section 2. Bank of deposit is agent for collection.

This section creates the relationship of principal and agent upon the deposit of every check, in the absence of an expressed agreement to the contrary. The effect of the section may, in given cases, be to change the relation between the parties as evidenced by written instrument. The section is evidently designed to meet the decision of the Supreme Court of the United States in the case of City of Douglas v. The Federal Reserve Bank of Dallas. In our opinion, it is better to let the status of the parties be established by the facts as made rather than to attempt to fix the responsibility by statutory provisions. This section apparently is inconsistent with section 4.

Section 3. Items on same bank.

It is believed that this section will give rise to much confusion and litigation. In the first place, it is to be noted that, by the provisions

of this section, where a bank receives a check drawn on it for deposit or credit, the check is deemed to be paid at the time of its receipt unless at such time the funds of the drawer or maker thereof are insufficient. If banks handled only one check per day of any given depositor, this provision might, theoretically, work all right, but during a day's business any bank will receive numbers of checks issued by the same drawer. There is no provision made by any bank in this district, that we know of, to record the time of the receipt of their several deposits. Accordingly, it would be impossible to determine whether or not a given drawer, the total of whose checks would overdraw his account, had a balance with the drawee bank at the time of its receipt of his check. Likewise, the last portion of the section is subject to a similar criticism, because there is no record made of the time of receipt of checks. For these two reasons, it appears to us that the article would give rise frequently to confusion, resulting in litigation and expense to every bank. Furthermore, checks are commonly received on deposit without careful scrutiny, and frequently the bank receiving same desires to return the check without paying it, because of irregularities. Under the provisions of this article, the bank would probably have no right to return said checks, where the drawer had a deposit. We are of opinion, also, that the last phrase, dealing with set-off, would give rise to much confusion.

Section 4. Legal effect of indorsements.

The definition of the effect of an endorsement "for deposit" is subject to the same criticisms made of section 2. The definition of the legal effect of the endorsements "for collection and remittance" and "for collection and credit" appear to be merely a restatement of the definitions which have universally been accorded these endorsements by the courts of the country. The definition of the legal effect of endorsements "in blank" or "in full", is subject to the same criticisms as section 2, and also furnishes the basis of a hiatus between ownership and presumption of ownership, which gives rise to uncertainty of the rights of various parties. The definition of the legal effect of an endorsement by the bank of deposit or subsequent holder "in blank" or "in full" appears to be in conflict with the provisions of section 2, in that the definition creates a presumption that, where a bank of deposit endorses an item "in blank" or "in full", it is the owner of the item, whereas, under section 2, it would be only an agent to collect. The definition of the legal effect of the endorsements "pay any bank or banker" is merely the definition commonly accorded this phrase. The definition of the legal effect of the endorsement "prior endorsements guaranteed" would at least give some interpretation of the meaning of this endorsement, and, in our opinion, would give the correct interpretation. The section is not clear as to how the presumption could be overcome.

Section 5. Duty and responsibility of bank collection agents.

The effect of this section is merely to render the Massachusetts rule applicable.

Section 6. Rules of ordinary care in forwarding and presentment.

The matters set out in subsection (a), except the proviso contained

in the last clause of the subsection, are, in our opinion, proper. However, the proviso leaves a very dangerous uncertainty, and, while it may express the law as it now exists, in our opinion its incorporation into a statutory law would be most unwise. We are particularly adverse to the words "or reasonable ground to believe". Under this phraseology, a very dangerous question might be raised in connection with every bank failure.

We have no criticism to make of subsection (b), except that the proviso in the last sentence is, in our opinion, subject to the same criticisms as the proviso in subsection (a).

The provisions of subsection (c) are subject to the same criticisms as section 3.

This section apparently approves a circuitous routing and might, therefore, be used as a basis to uphold actual negligence in routing checks in a circuitous manner.

Section 7. Rules of ordinary care upon dishonor.

We see no particular objection to this section. We do not understand however why the exception in case of express instructions or custom. If liability fixed in accordance with Negotiable Instruments Act there would be no damages.

Section 8. Duty of Inquiry.

The duty imposed by this section is more stringent than the custom of Federal Reserve Banks. As we understand it, Federal Reserve Banks do not trace in every instance on the day remittance is due. While the duty here set forth and made compulsory covers matters which are ordinarily done, we see no reason to make the duty mandatory. If incorporated into statutory law, this section might give rise, through court construction, to a liability which, at present, does not exist.

Section 9. Medium of payment.

We see no objection to this section, other than (e). Our objection to this portion of the section is based on our previous criticism of the definition of "solvent credit". The last sentence of this section is, we think, very loosely drawn and would give rise to many questions of liability which do not now exist. We refer praticularly to the words "or reasonable ground to suspect that such drawee or payor is about to close its doors" and the words "without first taking any and all steps which a prudent owner thereof would take", etc.

Section 10. Collection of paper taken in payment.

This section is subject to the same criticisms as section 9.

Section 11. Continued liability of drawer.

We see no objection to this section.

Section 12. Duty of receiver.

We have no objection to this section.

Section 13. Preferences in case of insolvency.

We see no occasion for collection code to deal with the question of preferences. We therefore feel that section 13 is entirely inappropriate.

Section 14. Lien of collecting bank.

We see no occasion for a collection code to deal with the question of a lien which a bank might have, but, on the other hand, we think that this question should be decided by the established law of the respective states of the Union. For these reasons, we feel that the provisions of section 14 have no place in a collection code.

Summarizing the proposed code: We see no occasion, if the code is enacted, for it to go further than to cover the uncriticized portions of sections 6, 9, 10 and 11.

(S) Locke, Locke, Stroud & Randolph.

Copy X-6085-g

FEDERAL RESERVE BANK
of
ST. LOUIS

February 29, 1928.

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

Dear Mr. Wyatt:

Examining the proposed UNIFORM BANK COLLECTION CODE prepared by Mr. Paton from the stand-point of its effect on Federal Reserve Banks as Collection Agents, I can find no objection until Section 6, caption - RULES OF ORDINARY CARE IN FORWARDING AND PRESENTMENT is considered. I believe that part of paragraph (a) section 6 - hereinbelow quoted - unduly broadens the Federal Reserve Banks' liability in its Clearing House operations:

> "Provided it shall not be deemed ordinary care to forward an item for collection to any bank as to which the forwarding bank has knowledge or reasonable ground to believe that it is not in a sound financial condition and is either insolvent or approaching insolvency."

Under the wording quoted, the liability is extended to cover cases where we have reasonable ground to believe the bank not to be in a sound financial condition or where it is approaching insolvency.

When a bank is insolvent in fact, and, when it is not in a sound financial condition or approaching insolvency - are entirely two different things. We know by experience that a bank may not be in a sound financial condition and there may even be reasonable ground to believe it is bordering on an insolvent condition and yet it may be able to weather the storm and get back on a sound financial basis. It appears to me that a Federal Reserve Bank ought not to be placed in a position where it will at its peril and before it handles an item on a solvent bank have to decide whether there is a reasonable ground to believe that the bank is approaching insolvency.

Under our 'Time Schedule' a day is fixed on which the bank expects to receive remittance on a cash letter theretofore sent out. It has happened in this district (and I suppose in others) that the Federal Reserve Bank may have sent a cash letter to a bank after the schedule date on which it should have received remittance for a former cash letter, and, upon investigation, it was found that the remittance drafts had been mailed in due time, but, because of something that happened between the mailing

date and the receipt date the remittance had not been received on schedule time.

Or, it might happen that a remittance draft covering a previous cash letter had been received, presented, and, protested - for want of funds - under circumstances where the remitting bank had sufficient funds in its vaults and with other solvent correspondents (subject to check) to pay all items presented (including the protested remittance draft,) and, upon 'Notice' of the protesting of the prior draft - for want of funds - the remitting bank would forthwith furnish a draft on a correspondent where it had sufficient funds, and the latter draft collected, NEVERTHELESS, if a loss occurred by reason of the sending of the subsequent cash letter after the dishonor of the first draft - the Court might hold the former unpaid remittance draft was sufficient evidence to constitute a reasonable ground for belief that the remitting bank was approaching insolvency, though it was in fact solvent at the time the remittance draft was dishonored.

Federal Reserve Banks, under the foregoing circumstances, would, in order to safe-guard and thoroughly protect themselves, have to handle the subsequent cash letters either by sending them by a messenger to make collection over the counter; or, by sending them to another bank to make collection; or, refuse to handle the items because of the unremitted for and outstanding cash letters. Either one of these three courses might in fact force a solvent, but weak bank, into an insolvent condition. WHEREAS, if the present method of handling collections were continued, and the remitting bank allowed to correct its mistake and furnish a collectable remittance draft - it would be able to weather the storm, and, eventually get back on a sound financial basis; consequently, the provisions quoted, I believe, would seem to be unnecessarily hard both on the remitting bank and the Federal Reserve Banks, and steps should be taken to have this section so modified as to lessen the liability of a Federal Reserve Bank - if it happens to guess wrong on the solvency of a collecting bank - for, it is possible that if the Federal Reserve Bank were to guess wrong and abruptly adopt a new method of making collections of the items contained in the subsequent cash letters, the change might cause a run on and the closing of a really solvent bank.

SECTION IX - MEDIUM OF PAYMENT

Under the following clause:

"In any case, however, where a bank collection agent has knowledge of the approaching insolvency of the drawee or payor of an item or reasonable ground to suspect that such drawee or payor is about to close its doors, it shall not be the exercise of ordinary care to accept in payment the check or draft of such drawee or payor without first taking any and all steps which a prudent owner of the item would take to obtain payment in money or a solvent credit under like circumstances."

before the Federal Reserve Bank could take the remittance draft of a drawee or payor bank, it would at its peril have to determine whether in fact the payee bank was approaching insolvency or about to close its doors, and, the same questions covered by the objections offered to Paragraph (a) Section 6, hereinabove quoted, should be considered.

Upon my return to St. Louis some pending cases and matters accumulated during my absence prevented earlier attendance to this subject.

Very truly yours,

(Signed) Jas G. McConkey.
Counsel.

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X-6085-h

THE PHILADELPHIA-GIRARD NATIONAL BANK.

Philadelphia December 28, 1927.

Mr. Albert C. Agnew, Counsel,
Federal Reserve Bank,
San Francisco, Cal.

Dear Mr. Agnew:

I am very glad indeed to have your letter of December 23, which gives me the opportunity to see for the first time Judge Paton's Uniform Bank Collection Code, and which I am returning herewith. I talked with Mr. Paton on this subject just a week or so ago while I was in New York, but we were both too busy to go into any detail, nor did he mention the fact that he had actually prepared a code.

I have read the paragraphs over, and also your criticisms, which in my judgment are both sound and pertinent. It was my pleasure and good fortune to work with Judge Paton in the New York offices of the American Bankers Association for a period of four years, from 1911 to 1915, during which time we frequently discussed this subject, as well as others, he from the legal point of view, and I from the practical standpoint. Needless to say, we differed on many points, and my general criticism of Judge Paton's Code is that his views, as formerly, reflect legal experience, whereas yours, on the other hand, show both legal and practical knowledge.

I have one or two suggestions which I would like to bring to your attention in addition to the constructive criticisms you have made. First- in reference to Section 4 - "Legal Effect of Endorsements". My opinion is that we should cut across considerable territory here, and recognize the bank endorsement stamp on the class of item we are discussing as being more than simply an endorsement in the sense that it is covered by the Negotiable Instruments Act. It is primarily a record, and the very presence of the item endorsed in the channel in which we find it is prima facie evidence of its status. I therefore see little point in Judge Paton's fine distinction between items endorsed "For Deposit", "For Collection and Remittance" and "For Collection and Credit". I believe questions arising in connection with items are questions of fact, and not questions of endorsement. Nor do I see any purpose in drawing a distinction between such items which the bank is collecting for a depositor and similar items which the bank itself may own. Always remembering, as I pointed out in Houston, that we are dealing with insolvent or failed banks, I cannot see that it makes any particular difference to anybody, especially to the failed bank or the Receiver thereof, or banks along the line, whether the bank of initial deposit is the agent collecting for a depositor, or whether such bank of initial deposit actually owns the items which it has accepted in payment of a debt due it.

Again taking a short cut, I would be very much in favor of legally providing for an endorsement stamp which would do three things:

1. Make it impossible for a check so endorsed to be negotiated between individuals or between an individual (not a banker) and a bank. In other words, the effect would be somewhat similar to the English crossing of checks.

2. The bank stamp should carry the same warranties and guarantees as are now carried by the endorsement on a negotiable instrument.

3. The stamp should be (as it usually is) simply a record of the bank handling such item, this for economy of space and cost of stamps.

Section 6. "Rules of ordinary care in forwarding and presentment". I believe it should be legally provded that it shall not be deemed ordinary care to forward an item for collection by a circuitous route. This would require some defining, but I think you get my thought. For example, a bank in San Francisco would be deemed careless or negligent should it send a check payable in Arizona to Spokane, Washington, for collection, whether by accident or design.

Your argument as to solvent credits is entirely sound, and is in line, you may recall, with the principles which I tried to lay down in the paper I presented at Houston. In my judgment, a solvent credit should be defined as credit by a bank that continues to accept deposits and make cash payments across its counter for a period two days longer than the ordinary mail time between the bank of original deposit and the place of payment. This is rather crudely put, but I think you will get the idea and the reasons therefor.

I have not taken the time to go into greater detail or elaboration in connection with one or two other minor suggestions, but what I have set down above covers in a general way the points that occurred to me as I read over Judge Paton's draft and your criticisms.

Thanking you for having given me the opportunity to review the correspondence, I am,

Yours very truly,

O. HOWARD WOLFE (sgd.)

Cashier.

X-6085-h

Copy

December 23, 1927.

Thomas B. Paton, Esq.,
General Counsel,
American Bankers Association,
110 East 42nd Street,
New York City, N. Y.

Dear Judge Paton:

I have carefully reviewed with the Deputy Governor and Cashier of this bank the uniform bank collection code, a tentative draft of which you recently sent me.

Many suggestions have occurred to us, both from an operating and a legal standpoint, and these suggestions I take the liberty of setting forth herein. I hope that you will not consider our comments entirely lacking in constructive force. You having set up a target for us to aim at, we have considered that your purpose would be better accomplished by criticism of what you have suggested than by the suggestion of alternatives only.

For the sake of convenience, our comments are segregated to correspond to the sections of the proposed code.

Section I. (b) You define a "solvent credit" as an unconditional credit of money on the books of a solvent bank to the account of another bank, requested or accepted by such other bank.

I believe there is great danger in the use of the word "solvent". Solvency is a relative term depending upon circumstances and conditions often not within the knowledge of the collecting bank, If, after the credit is received or accepted, it later appears that the bank upon the books of which the credit was given was not in fact solvent at the time of the passing of such credit, the responsibility, under the latter sections of the proposed code, is passed to the collecting bank. In many instances banks are going institutions meeting the demands made upon them in the usual course of business, but are not solvent under the generally accepted definition of that term.

The significance of the use of this term has perhaps been more forcibly impressed upon me by the rather disastrous outcome in the case of Federal Reserve Bank of San Francisco vs. Idaho Grimm Seed Growers Association (8 Fed. (2d) 922). In that case, while this bank knew that the Standrod Bank was in a badly extended condition, it did not know that the Standrod Bank was in fact insolvent at the time of the transactions referred to. You can see, however, the serious consequences which resulted from our dealing with the bank in good faith at a time when although a going institution, it was in fact insolvent.

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X-6085-h

FEDERAL RESERVE BANK

of San Francisco

February 28th,
1 9 2 8.

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

Dear Mr. Wyatt:

I am reminded that at the recent conference of Counsel to the Federal Reserve Banks, held in Washington, it was proposed that Counsel for each Federal Reserve Bank should send to you their criticisms and recommendations in relation to the uniform check collection code proposed by Judge Paton, General Counsel to the American Bankers Association.

Having already gone quite thoroughly over the Code, and having written to Judge Paton in regard to it, I do not believe that I can do better than send you a copy of the letter which I wrote to Judge Paton, and which I enclose herewith. This expresses quite fully my criticisms of the proposed code. I did not attempt therein to set forth any constructive suggestions of major import, because I did not consider that I should do so.

I also hand you herewith copy of a letter received by me from Mr. O. Howard Wolfe, Cashier of the Philadelphia-Girard National Bank, in response to a letter written by me to him transmitting a copy of Judge Paton's Code, and my letter of criticism. I believe that Mr. Wolfe's reaction, being that of a practical banker, is worthy of consideration.

If there is anything further that I can do to assist you in sifting down the criticisms in regard to the Code, please let me know.

I still retain most pleasant recollections of my recent visit to Washington, a trip always made so much more enjoyable by reason of the warm hospitality of Mrs. Wyatt and you. I only hope that I may some day have the opportunity and privilege of entertaining you both in California.

Just before my departure from Washington, I ordered a potted plant sent to Mrs. Wyatt. Having obtained your address from the telephone directory in great haste I am curious to know whether the plant reached its destination. After I boarded the train, I felt that I had not given the address correctly.

Cordially yours,

(Signed) Albert C. Agnew,
Counsel

ACA/S
Enc. (2)

I believe that the word "going" should be substituted for the word "solvent", or else the word should be defined by stating that solvency shall be conclusively presumed if the institution in question continues open for business for a specified time following the payment of the item.

Section 2. It is our opinion that the instruments included within the purview of this section should not be restricted to negotiable instruments. It is a fact which the transit manager of any Federal Reserve bank will confirm that there are daily handled as transit items hundreds of instruments which, while they are not strictly negotiable, are in common practice passed through the transit department. Included in such items are pay checks, due bills, and sight drafts of insurance, railroad, and other large corporations so drawn as not to be negotiable. It seems to us that the relation of agency should surround the collection of such items as these as well as items negotiable in form.

Section 3. I believe that you are entering dangerous territory when you attempt, as you have in this section, to fix the definite time at which an item received on deposit for credit to the payee and drawn on the bank of deposit shall be considered paid. In the event of the insolvency of either the paying bank or the depositor, there is involved the question of marshalling of assets, which, if the time for payment is to be definitely set, will become extremely difficult and will lead to litigation. It seems to me that the same purpose could be accomplished and much confusion avoided if this section stated merely that a bank receiving on deposit a check drawn upon itself would have the privilege of returning such check to its depositor the following morning if, at the close of business on the day of deposit the check is found not to be good. This same matter arises under Section 6 (c).

Section 4. I would suggest adding after the words "that the indorsee bank" in the second line of this section the following: "and each subsequent indorser prior to the drawee", so that the first sentence as amended would read:

> "An indorsement of an item by the payee or other depositor 'for deposit' shall indicate that the indorsee bank and each subsequent indorser prior to the drawee is an agent for collection and not the owner of the item."

I also suggest adding after the words "an indorsement 'pay any bank or banker'" in the line fifth from the bottom of the first page, the words "or other analogous indorsement".

I believe that the words "where coupled with the words 'prior indorsements guaranteed'" on the lines second and third from the bottom of the first page, should be eliminated so that this sentence as amended will read: "and shall constitute a guaranty by the indorser to all subsequent holders, etc."

This matter involves a controversial subject upon which there is a serious difference of opinion. I am, and always have been of the opinion that a restrictive indorsement does not relieve the party so indorsing of the usual warranties attaching to a general indorser under Section 66 of the Negotiable Instruments Act. This section provides that every indorser who indorses without qualification makes certain warranties and read with Section 65 of the Act, to my mind, must be construed to mean that every indorser, including a qualified indorser, as defined in Section 38, and including a restrictive indorser, warrants that the instrument is genuine in all respects, and that at the time of his indorsement it is valid and subsisting. It would not be appropriate to argue the matter further here but I call your attention to the following authorities:

Ann. Negotiable Instruments Law, Crawford, page 130,
Quatman v. Superior Court, 42 Cal. App. Dec. 336,
First Nat. Bank v. Bank of Barnesville (Ohio) 41 L.R.A. 584, 586;
Daniel's Negotiable Instruments, 6th Ed. pp. 744 and 746,
9 Corp. Juris, 394,
Interstate Trust Co. v. U. S. Nat. Bank (Colo.) 185 Pac. 260,
In re. Ziegenheim (Mo.) 187 S.W.893.

Section 6 (a). I believe that the last three and one-half lines of this subsection, commencing with the word "provided" should be eliminated. The inclusion of this proviso places a heavy and almost prohibitive responsibility upon the collecting bank. It would, in my opinion, defeat the very purpose for which the direct-sending statute was intended, and would result in endless and vexatious litigation. Under ordinary circumstances the forwarding bank is not in position to judge whether or not the bank to which the item is sent is insolvent or approaching insolvency. If any large collecting bank or any number of banks should come to the conclusion that a given bank was "not in sound financial condition", or was "approaching insolvency", and in order to avoid possible liability adopted extraordinary means for collecting checks, such as presentation over the counter directly or through a local agent, the drawee bank would immediately be forced to close. We have had experience in this district with many banks which were in an extended condition and which might be said to be "approaching insolvency" which have survived, and are now flourishing institutions. The adoption by this bank of unusual means for collecting checks on such banks would have spelled nothing but ruin for such institutions. It seems to me that it is infinitely better to omit the provisio and leave the determination of what shall constitute ordinary care to the circumstances existing in each particular case.

(b) The same observations as those last herein stated apply to the proviso contained in this subsection. I strongly recommend its elimination.

(c) It seems to me that it would be better to either eliminate this subsection or to so alter it as not to confine the payor bank to an exact method or order for the payment of checks. As you know, checks received by the payor bank and drawn upon it are received from four sources: those cashed over the counter, those deposited for credit, those received through the clearing house, and those received through the mails. In large banks it is utterly impossible as an operating detail to determine the order in which such checks drawn upon a given account are received. In many of the larger banks cash letters received through the mail after two p.m. are arbitrarily held over until the next day and in many instances it might happen that after the hour fixed beyond which cash letters would not be functioned, checks would be received and cashed at the counter or received for deposit over the counter. To particularize as closely as this subsection does on the matter of order of payment, it seems to me would accomplish no good purpose and would be productive of controversy.

Section 7. This section merely provides in substance that upon dishonor the drawee, or other agent, may follow the provisions of the Negotiable Instruments Act, and in so doing shall be exempt from liability. It appeals to me as stating a self-evident proposition and I believe should be eliminated.

Section 9. If this section is to be included, it seems to me that it should be provided that the check or draft of the drawee or payor given in settlement or in payment of an item or items must be finally collected in solvent funds. In other words, some restriction on the number of drafts which may be taken in the process of collection should be included. Otherwise, under the code as drafted, a collecting bank would be privileged to accept a remittance draft from the payor and another remittance draft from the drawee of the first draft, and so on ad lib, the parties in interest in the meantime not being in receipt of final credit. The collecting bank should be required to obtain immediately available funds for the first remittance draft.

Section 11. Change the words "ordinary care" in the fifth line of this section to the words "due care as defined herein".

It seems to me that the latter part of this section, commencing with the words "where the draft" might well be combined with the substance of section 12, and subsection "a" of section 13. The object sought to be accomplished, I take it, in the event of the dishonor of a remittance draft through the insolvency of the paying bank, is to place all of the parties to the transaction back in their original position. Might this not be accomplished with more clarity by stating in one section in substance that in the event of the failure of a payor bank before its exchange draft sent in remittance has been collected, such draft shall be returned to the payor bank, which bank shall in turn re-credit its depositor's account with the amount

of the checks covered by the draft in question, the checks to be returned to the bank from which received and by such bank to the original depositor.

It seems to me also that the latter part of section 11 should not be confined to items which have been exchanged "through the clearing" but should apply to all drafts given in payment of transit items.

Section 13. In the event that my suggestions in regard to the latter part of section 11, and section 12, are followed, subsection (a) of section 13 will, of course, become unnecessary. The reversal of entries by the payor bank and the return of the original checks, if obtainable, to the bank from which they were received, will eliminate any possible claim of preference against the insolvent bank. Some provision should be made for giving the original depositor of the checks some evidence of his claim against the drawer of the checks in those cases where the checks have been returned to the drawer with his other cancelled vouchers.

Section 14. I suggest adding after the word "asserted", being the first word in the line second from the last, the following: "or any prior indorser". If the instrument upon its face, or by any previous restrictive indorsement, indicates that the bank against which a lien is asserted is not the owner of the item but an agent merely, no lien should be allowed to the bank in possession of the item. This idea is carried out in the previous part of the section as drafted.

I trust that you will pardon the length of this communication which I do not seem to be able to abridge without slighting the important subject at hand.

Yours very truly,

(Signed) Albert C. Agnew
Counsel

ACA:JH

P.S.: Referring to Section 6 (b), considerable hardship would result in many cases if the collecting bank is restricted, in collecting a check drawn on another bank in the same city, to presenting such check at the counter of the drawee or through the local clearing house. In both Seattle and Los Angeles, for instance, there are a number of small outlying banks within the corporate limits of the cities mentioned which are not members of the clearing house and in relation to which presentation by messenger would consume the major portion of the business day in making the round trip. I have no doubt that this situation exists in many other large cities.

In these cases we have followed the practice of sending the items direct to the drawee by mail and accepting the drawee's draft in settlement through the mail. If the code as drafted should become law, such method of presentation would, of course, not constitute the exercise of ordinary care; this, although there is no practical method of collecting such items other than the one followed. I merely submit this for your consideration.

A.C.A.

COPY

FEDERAL RESERVE BANK

OF RICHMOND

X-6085-i

February 17, 1928.

Federal Reserve Board,
Washington, D. C.

Attention: Mr. Walter Wyatt, General Counsel.

My dear Mr. Wyatt:

On my return from the Conference of Counsel of Federal Reserve Banks I found it was necessary for me to go to South Carolina on a business trip, and, consequently, I have had no previous opportunity to write you upon the subject of topic No. 11.

I received a copy of the Uniform Bank Collection Code from Mr. Thomas B. Paton and in going over it one or two points occurred to me which I mention below:

Section 3 - This section provides in substance that a check which is deposited in the bank upon which it is drawn may be charged back to the depositor if there are no funds to the credit of the depositor when the check is deposited and if the check is not made good during the business day. The justice of this provision is scarcely open to question, but I am afraid that in operation much uncertainty will arise from the difficulty of determining the order in which one or more checks are deposited. Most banks in large cities have two or more tellers' windows at which checks are received on deposit and the bank has no way of determining with exactness the hour at which a particular deposit was received. Assume for the sake of argument that John Doe has upon deposit the sum of $100.00 and about midday two checks drawn by John Doe to the order of Richard Roe and Charles Coe are deposited and that each of these checks is for $100.00. I assume that the first in time would be reckoned the first in right and that the bank would be obliged to devote the deposit to the payment of the check deposited by Charles Coe if that was first deposited and vice versa, but the bank would be without means of determining which of these two checks had been first received. Indeed, it is theoretically possible that the deposit of the two checks might have been simultaneously made at different windows, and if the two checks had been deposited at about the same time it would nearly always be impractical to determine which had been deposited first.

Section 4 - I believe that this section clarifies the law and establishes a just rule, but it may be the occasion of some loss to some banks. I have found that banks are very anxious to be considered as mere collecting agents when they fail to make a collection but they are equally anxious to be able to use items entrusted to them for collection as a basis for credit. Nearly all banks in sending checks to another bank

use the endorsement: "Pay any bank or banker," but the receiving bank frequently gives immediate credit to the sending bank for checks bearing this, or, indeed, any other form of endorsement. If bank "A" has received a check endorsed in blank and endorses it "Pay any bank or banker," and sends it to bank "B" and bank "B" sends it to bank "C" with a similar endorsement, bank "C" would frequently give immediate credit to bank "B". Therefore, if bank "B" should fail, bank "A" or the holder of the check could reclaim its proceeds in the hands of bank "C" and apparently defeat bank "C's" claim to apply the apparent balance of bank "B" to an indebtedness due by bank "B".

I think that the practice that banks have of giving credit upon uncollected checks is a pernicious practice and a law which discouraged it would be a good law but it might give rise to some dissatisfaction before its effect was generally understood.

Section 6 (c) - The objection which I mentioned as applicable to Section 3 is equally applicable to Section 6 (c). Indeed, it is more difficult to determine whether or not a check received through the mails was received before or after another check received through the mails, or before or after another check deposited at the counter. Any number of checks drawn by the same depositor may be simultaneously received in a single delivery of mail.

Section 8 - This section expresses what is practically admitted to be the duty of a forwarding bank, but it seems to me that some difficulty may arise from the use of the words "in due course of mail." It is difficult to determine with exactness the time which should elapse between the dispatch of a letter and the receipt of a reply as this time frequently depends upon whether or not railroad connections are made at remote junction points. I believe that very few banks attempt to trace items upon the exact day upon which advice of payment or non-payment should have been received, usually allowing some margin of time on account of possible delays in the mails. It seems to me that it would be better to use the words "within a reasonable time" rather than the words "in due course of mail."

It seems to me that Sections 11 and 13 (a) are inconsistent. Section 11 abrogates the rule under which the drawer of a check is released by the surrender and cancellation of that check by the drawee bank if the drawee bank fails to make payment to the collecting bank. Under the rule established by the proposed code it would seem that the holder has no claim against the drawee bank, for the holder would be entitled to the return of his check as if it had been dishonored upon presentation. It seems to me, therefore, that Section 13 (a) is superfluous.

Section 11 changes a long established rule of law and the change will create great uncertainty as to the time which such checks as are declared by Section 11 to be unpaid were dishonored. In other words, it seems to me, therefore, that Section 11 should be elaborated by the insertion of a provision to the effect that items which are cancelled but

upon which the drawers are not discharged should be deemed dishonored when the holder or collecting agent discovered that payment in money or a solvent credit could not be obtained. In other words, the time for giving notice of dishonor should begin to run when the remittance draft was dishonored or when the collecting bank found that the check had been cancelled and no remittance draft sent.

I remain,

Very truly yours,

(S) M. G. Wallace,
Counsel.

MGW L