C O P Y

X-6130

IN THE DISTRICT COURT OF THE UNITED STATES
in and for
THE EASTERN DISTRICT OF ILLINOIS

In Equity No.____

J. F. JARVIS, et al.,

Complainants,

v.

OTTO KEPP, et al.,

Defendants.

BRIEF IN SUPPORT OF MOTION TO DISMISS.

STATEMENT OF FACTS AND PROCEEDINGS

The original petition in this case was filed in the State Court by the present plaintiffs, a group of depositors of the Neoga National Bank, against the officers and directors of that bank. That petition was substantially like the amended petition now before this court, so far as the allegations asserting liability against the officers and directors of the Neoga Bank are concerned. This case was, upon petition, removed from the State Court to the United States District Court for the Eastern Division of Illinois, and after removal the amended bill of complaint was filed. In the amended bill of complaint the Federal Reserve Bank of Chicago was for the first time made a party and there were added allegations which attempted to assert liability against the Federal Reserve Bank of Chicago.

The present hearing is upon a motion of the Federal Reserve Bank of Chicago to dismiss the amended bill of complaint as to it, on two grounds:

(1) That the amended bill of complaint fails to state a cause of action against the Federal Reserve Bank of Chicago, and

(2) That there is a misjoinder of causes of action in that an entirely different cause of action is sought to be set up by the complainants against the directors and officers of the Neoga Bank from that sought to be set up against the Federal Reserve Bank of Chicago.

In the amended bill of complaint, it is alleged that the Neoga National Bank was incorporated in 1905 with a capital of $25,000.00, and continued to do business in the Village of Neoga until the 12th day of January, 1925, at which time it suspended business by direction of a national bank examiner, and the Comptroller of the Currency appointed a Receiver for the bank. The original Receiver, Mr. Shubert, was succeeded by Mr. Harry B. Marsh during the year 1927. Mr. Marsh, as Receiver, is made a party to the amended bill. The directorate of the bank remained practically unchanged during the three or four years preceding its suspension and the nine directors who acted during that period are all named parties defendant with the exception of Stephen Burton. Mr. Burton having died, his heirs at law, to whom his estate has been distributed, are made parties defendant by the bill. Judgment is asked against the individual directors and officers on the alleged ground of

their careless and negligent management of the affairs of the bank, and also on the ground that they wrongfully and unlawfully accepted deposits from the plaintiffs when they (the directors and officers) knew or should have known that the Neoga National Bank was insolvent.

The prayer of the bill asks as to the directors and officers,

> "that they and each of them be required and compelled thereby to account for and pay over to the complainants and other depositors of The Neoga National Bank of Neoga, Illinois, such sums of money with interest thereon as have been lost to the complainants and each of them and other depositors of said bank, by, through or on account of their wrongful and unlawful acts aforesaid; and that they and each of them be required to reimburse the complainants and each of them for all losses occasioned to the complainants or either of them by the mismanagement of said bank or by their neglect or failure to discharge their duties as officers or directors of said The Neoga National Bank, and that they be required as trustees for the complainants and each of them to account for and pay over to the complainants and each of them the funds and deposits aforesaid of the complainants and each of them lost through and by the wrongful and unlawful acts of said defendants who were directors of said The Neoga National Bank of Neoga, Illinois, as hereinbefore set forth;"

The prayer for judgment against the Federal Reserve Bank of Chicago is in these words,

> "That your orators may have a decree against the defendant, FEDERAL RESERVE BANK OF CHICAGO, requiring it to account to the Receiver of The Neoga National Bank of Neoga, Illinois, for such sums of money with interest thereon as have been lost to the complainants and each of them and other depositors of said bank, by, through or on account of those wrongful and unlawful acts as aforesaid,"

An examination of the amended bill discloses various allegations, which will be later considered in detail, charging that there was by law a duty upon the Federal Reserve Bank of Chicago to examine the Neoga National Bank, and that if such examinations had been made, the Federal Reserve Bank of Chicago would have discovered the alleged misconduct of the directors and officers of the Neoga National Bank and the insolvency of the bank; but it is not alleged that the Federal Reserve Bank of Chicago could have taken any disciplinary action as a consequence of such discovery on its part. It will hereafter be shown that the Federal Reserve Bank of Chicago owed no such duty to the depositors of the Neoga National Bank, and that no "wrongful and unlawful acts" are in fact well charged against it in the amended bill.

Apart, however, from the allegations which thus seek to charge negligence against the Federal Reserve Bank, the bill does claim a right, on the part of the petitioners, to relief growing out of the fact that upon suspension of business by the Neoga Bank under the orders of the Comptroller of the Currency, the Federal Reserve Bank of Chicago appropriated the stock interest of the Neoga National Bank in the Federal Reserve Bank of Chicago of the value of $1,000.00, crediting its value upon the indebtedness of the Neoga National Bank to the Federal Reserve Bank of Chicago; and further set off against that indebtedness the deposits of the Neoga National Bank in the Federal Reserve Bank of Chicago to the credit of the reserve

fund; and further used the collateral of the Neoga National Bank to the extent necessary to pay the residue of the indebtedness.

From the foregoing it is clear that the causes of action sought to be set up against the Federal Reserve Bank of Chicago have to do: first, with the alleged duty of the Federal Reserve Bank of Chicago to examine the affairs and discipline the officers of the Neoga National Bank; and second. with the action of the Chicago Federal Reserve Bank, after the suspension of the Neoga Bank, in the application of resources of the Neoga Bank in its hands, so far as they were necessary, to the payment of the indebtedness of that member bank to it. Neither of these alleged causes of action grow out of, or are in any way associated with, the alleged negligence and misconduct of the directors and officers of the Neoga Bank.

The causes of action attempted to be asserted against the Federal Reserve Bank of Chicago both rest upon the duties imposed upon and the rights given to Federal reserve banks by law. These duties and rights can be determined only by an examination of the Federal Reserve Act, which, of course, is to be interpreted as a whole and so construed as to accomplish the great public purposes for which it was passed.

THE FEDERAL RESERVE SYSTEM:
Federal Reserve Banks and Member Banks.

The Federal Reserve Act was approved by the President on

the 23rd day of December, 1913. Its title is as follows:

> "An Act to provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." (The Federal Reserve Act, 38 Stat. 268; Comp. Stat. An. 1916, Sec. 9799; 39 Stat. 792; 40 Stat. 238; is best found in U.S.C.A., Title 12, Sec. 221 et seq.)

Prior to the passage of the Federal Reserve Act, national banks were incorporated and governed under the National Bank Act passed at the close of the Civil War. The characteristic of the National Bank Act was that it provided for the issuance of national bank notes as the principal reliance of the country for currency, and based the amount of such notes at any time possible upon the amount of bonds of the Federal Government outstanding. The debt of the National Government by reason of war expenditures was very large and for some years Government bonds could be bought by national banks at so favorable a rate as to enable them to supply adequately the country's needs for currency. As the national debt began to be paid off, however, the basis for currency issued was constantly narrowed. Meanwhile, with the commercial, industrial and agricultural development of the country, the need for currency increased. The consequence of this was that the currency of the country became rigid and inelastic, and the demand for currency excessive and fluctuating, until finally the country reached the situation where industrial and commercial prosperity created a certainty of currency stringency with resulting

panic. A further cause of panics, crises and depressions arose from the fact that by the National Bank Act, national banks were required to maintain reserves based upon stipulated percentages of their deposit liabilities. These reserves were required to be deposited in other banks in reserve and central reserve cities, and in the course of time, the practice grew up of concentrating national bank reserve deposits in great metropolitan banking centers where employment was found for surplus funds by loans for speculative purposes. When stringencies arose and depositors began to withdraw their deposits, banks were obliged to call in their reserves. As these calls increased, they accumulated pressure on the great metropolitan banks causing rapidly rising rates for call money, dumping of securities in stock markets, with consequent falling prices, and, all too often, commercial and bank failures, which quickly enlarged a relatively local bank scare into a general panic.

The very nature of the financial system of the country, therefore, was such that panics were inevitable and the frequency and severity of their occurrence increased with the development and expansion of the country's business. To meet this situation Congress passed the so-called Aldrich-Vreeland Act of May 30, 1908, which sought to lend elasticity to the currency by authorizing the issuance of currency based

upon commercial paper by the association of banks known as the National Currency Association. This Act was temporary in character and purpose, one section of it authorizing the appointment of a National Monetary Commission to study the problem and suggest more fundamental and permanent relief. The report of the National Monetary Commission made clear the evils to be cured: namely, the inelasticity of the currency and the lack of real reserves available to meet and relieve financial uneasiness.

The Federal Reserve Act was drawn and passed to cure these evils. The title of the Act quoted above shows that its primary purposes had to do with the establishment of real reserves in Federal reserve banks and authorization of an elastic currency. The title further shows that the Act aimed at a more effective supervision of banking in the United States. This, of course, does not say a supervision of "banks" but a supervision of "banking" and it will later be made clear that the supervision in question had to do with banking practices necessary to be controlled to assure the character of commercial paper to be used as a currency basis, and with reserve deposits, which were by the law required to be accumulated in Federal reserve banks rather than in private banks and thus removed from speculative engagement.

An examination of the Federal Reserve Act shows that

it establishes an agency of the Government for the accomplishment of public purposes. At the head of the system is an official board composed of officers appointed by the President and confirmed by the Senate, having no invesement interest in any bank in the system, and exercising public powers. The Federal reserve banks as distinguished from the Federal Reserve Board are regional. All national banks in each district are required to be members of the Federal reserve bank of the district and to subscribe in a fixed proportion to its capital stock. Eligible state banks and trust companies are invited to join the System under an equality of burden and of opportunity with the national banks, but the whole System is a public, official thing. The directors of the Federal reserve banks are of three classes, the members of one class being appointed by the Federal Reserve Board. But the stockholding banks are limited to an accumulative dividend of 6% on the paid in capital, and throughout the entire Act it is clear that the Federal reserve banks, acting under the direction and control of the Federal Reserve Board, are agencies of the Federal Government, exercising governmental power, equipped with the right to acquire information wherever necessary to enable them to exercise that power wisely, and with certain disciplinary power over the member banks, which, however, is limited to that necessary to insure

performance by the members of those obligations to the system which are necessary to carry out the public purposes for which the banks were organized. There is no suggestion anywhere in the act of any duty running from Federal reserve banks to the stockholders and depositors of member banks. As a matter of fact, at the time of the debate upon the Federal Reserve Act, an amendment was rejected by Congress to introduce what would in effect have been a guarantee of deposits to member banks, and the Act was left without any such direct or even analogous provision.

FUNCTIONS AND POWERS OF FEDERAL RESERVE BANKS

From the foregoing it is clear that Federal reserve banks are not private money making institutions but are rather instrumentalities of the Federal Government through which definite national purposes are accomplished. Specific sections of the Federal Reserve Act illustrate this statement. Thus U.S.C.A., Title 12, Ch. 3, Sec. 248 enumerates the powers of the Federal Reserve Board and each of these powers is shown to have a public object related to the maintenance of sound financial conditions throughout the country.

Sec. 281 et seq. show the method of organizing Federal reserve banks. Sec. 341 enumerates the powers of Federal reserve banks, and it is here significant to note that even

Federal reserve banks may not transact business until they have been duly authorized thereto by the Comptroller of the Currency. The extension of credit accommodations, the issuance of Federal reserve notes, and a par collection system for the general benefit of the financial system of the country are all shown in the succeeding sections, and very strict limitations are provided in the statute as to what Federal reserve notes may be authorized to be issued, and how issued notes shall be protected by gold deposits in the Treasury. (Sec. 414). In like manner, beginning with Sec. 461, the subject of bank reserves is fully covered. Throughout these sections it will be found that such supervisionary power as is given to the Federal reserve bank over its members had to do with the protection of the reserve, or the safeguarding of currency issued, or otherwise furthering the great general purposes of the Federal Reserve Act in the way of preventing the devotion of expanded currency facilities to speculative uses of the prejudice of sound business undertakings. Nowhere in these sections is any general or specific visitorial or disciplinary power given to Federal reserve banks over their members.

All national banks are required by this Act to be members of Federal reserve banks. The Neoga National Bank was a national bank. The bill of complaint alleges that the Neoga Bank was organized in 1905 as a national banking association.

It was, therefore, organized some years before the enactment of the Federal Reserve Act. When the Federal Reserve Act was passed, there was no concurrent repeal of the earlier National Bank Act. The system of national banks then in existence was continued. The method of organizing, operating, controlling, disciplining and dissolving national banks remained unchanged. National banks were tied into the Federal Reserve System in definite ways for definite purposes, but remained otherwise as they had been under the old National Bank Act. It is, therefore, important to state briefly just how national banks are organized, disciplined and controlled.

U.S.C.A., Title 12, Ch. 2, beginning with Sec. 21 (Rev. Stat. 5133 et seq.) deals with that subject. An examination of these sections shows that the Comptroller of the Currency, acting under the direction of the Secretary of the Treasury (Rev. Stat. Sec. 324; U.S.C.A., Title 12, Ch. 1, Sec. 1), is the center of authority with regard to national banks. They can be formed only upon his approval as provided in Secs. 21 and 22. He keeps the records of their organization and only when he has approved the steps by which they were organized can they begin to transact business as national banks. (Sec. 26 and 27). All changes in their organization, location or name must be first submitted to and approved by the Comptroller. Consolidations and the

establishment and operation of branches are subject to the Comptroller's approval, and state banks may become national banks only after having satisfied the Comptroller of their compliance with the requirements of the statutes.

The enforcement of the National Bank Act is placed in the hands of the Comptroller by Sec. 93 (Rev. Stat. 5239), and by Sec. 191 the Comptroller is given authority to appoint Receivers when in his own sound discretion he has become satisfied that a national bank is insolvent. In order that the Comptroller may have the information upon which to base this visitorial and disciplinary action, it is provided in U.S.C.A. Ch. 3, Sec. 481 (Rev. Stat. 5240):

> "The Comptroller of the Currency, with the approval of the Secretary of the Treasury, shall appoint examiners who shall examine every member bank other than those expressly excepted by Sec. 330 of this title, at least twice in each calendar year and oftener if necessary;"

It is thus clear that all examinations of national banks to detect and correct negligence or misconduct of the kind alleged in bill of complaint against the officers and directors of the Neoga National Bank is committed to the Comptroller of the Currency and not the Federal reserve bank or Board. This was true before the passage of the Federal Reserve Act and remains true now. A different situation exists with regard to state banks, members of a Federal reserve

bank. We are not concerned with them in this case and it will be sufficient to say that state banks objected to being examined by national bank examiners as they were already subject to examination by state bank examiners. A limited discretion was, therefore, given to the Federal reserve bank to examine member state banks when for any reason the Federal reserve bank in question declined to accept the result of examinations by state examiners. But with regard to national banks the statement above made is true. The entire power of examination and discipline over national banks remains in the Comptroller as it was before the passage of the Federal Reserve Act. Certain discretionary and voluntary rights of supplemental examination are given to the Federal reserve banks with regard to member national banks for specific purposes, but they are not visitorial or disciplinary and they impose no duty upon the Federal reserve banks of the kind alleged in the bill of complaint. With these general observations we may now proceed to examine the causes of action attempted to be set up against the Federal Reserve Bank of Chicago in the bill of complaint in this case.

I.

THE AMENDED BILL DOES NOT STATE A CAUSE OF ACTION AGAINST THE FEDERAL RESERVE BANK OF CHICAGO.

At the outset it is important to separate the allega-

tions of the bill of complaint into two classes:

1. Those which alleged a breach of duty growing out of the negligent or careless failure on the part of the Federal Reserve Bank of Chicago to examine the Neoga Bank; and

2. Claims asserted because of the action taken by the Federal Reserve Bank of Chicago after the insolvency of the Neoga Bank.

1. Alleged Failure of Duty of Federal Reserve Bank of Chicago.

For the convenience of the court, we set out here serially all the allegations of the bill of complaint dealing with the alleged failure of the Federal Reserve Bank of Chicago to take action which it is asserted it was its duty to take for the protection of the complainants.

In paragraph 2, page 3, it is said:

> "***that said Acts of Congress also required said bank to be a member of the Federal Reserve Bank of Chicago and empowered said Federal Reserve Bank when extending credit to a member bank to supervise and examine the business of such member bank in like manner to the supervision and examination exercised by the Comptroller of the Currency;"

In paragraph 9, page 7, it is said:

> "***said directors were constantly required to make reports of the financial condition of said bank over their individual signatures to the Comptroller of the Currency and also to the Federal Reserve Bank of Chicago."

Paragraph 12, page 11, in dealing with the alleged neglect of duty of the examining committee of directors of

the Neoga National Bank and reciting the things which should have put said committee on notice, says:

> "***and regardless of the constant requirements of the Federal Reserve Bank of Chicago that collateral of the face value of more than twice the amount of the money loaned to the Neoga National Bank should be held by said Federal Reserve Bank and regardless of the fact that the Federal Reserve Bank was in possession of substantially all of the valuable assets of said bank."

In paragraph 13, page 12, dealing with requirements imposed by the Comptroller of the Currency and by national bank examiners under his authority that the board of directors improve Neoga Bank's condition 'out of their private funds, it is said:

> "***that the Federal Reserve Bank of Chicago from whom the Neoga National Bank had borrowed more than $80,000.00 in 1920 by rediscounting a like amount of its notes with said Reserve Bank had been constantly making demands during all the years aforesaid on the said The Neoga National Bank to reduce said rediscounts and said board of directors had reduced said rediscounts in 1924 to approximately $51,000.00, that since the year 1921 the quality and character of said rediscounts were found so unsatisfactory and valueless that said Federal Reserve Bank required the said board of directors to turn over to said Federal Reserve Bank as collateral for said rediscounts additional securities or notes in approximately equal face value to said securities rediscounted; that the said rediscounts and collateral included substantially all of the notes and securities of said bank which were of any value; that the said board of directors being fully aware that the said Federal Reserve Bank had substantially all of its assets of any value in its possession and knowing that the vaults of said bank contained no securities of any substantial

value and contained only funds recently deposited by customers of the bank continued to keep said bank open for business;"

In paragraph 14, on page 13, it is said that the board of directors of the Neoga Bank made false and misleading reports to the Comptroller of the Currency and caused them to be published in The Neoga News,

"***and that by reason of the false and misleading character of said reports the Comptroller of the Currency and the depositors of said The Neoga National Bank were not informed as to the actual condition of said bank and failed to take steps to repair or put the bank in liquidation at a much earlier date by reason of which the losses of said bank were further increased."

Paragraph 16, on page 14, is in full as follows:

"Orators further represent that The Neoga National Bank was a member of the Federal Reserve Bank of Chicago from the organization of said Reserve Bank in 1913; that said Federal Reserve Bank was a corporation governed by a Board of Directors and the chairman of the Board of Directors is known also as 'Federal Reserve Agent'; that under the National Banking Laws the said Federal Reserve Bank of Chicago was empowered to rediscount bills and notes of member national banks and whenever any member national bank rediscounted paper with the said Federal Reserve Bank immediately said Federal Reserve Bank had full and complete authority under said banking laws with the approval of the said Federal Reserve Agent who was then and there the chairman of the Board of Directors of said Federal Reserve Bank to make special examinations of member banks rediscounting paper with said Federal Reserve Bank; that The Neoga National Bank had been rediscounting its paper with the Federal Reserve Bank of Chicago for some years and in the 1920 by means of said rediscounting had borrowed from said Federal Reserve Bank more than $80,000.00; that the National Banking Laws required the Federal Reserve Bank to so conduct such special examinations as to

inform the Federal Reserve Bank of the condition of its member banks and of the lines of credit which were being extended by them; that one of the objects in the establishment of the Federal Reserve Bank System was to establish a more effective supervision of the banks in the United States; that in the year 1920 the said Federal Reserve Bank made a requirement of The Neoga National Bank that it reduce its rediscounts with the Federal Reserve Bank and that it put up as collateral with said rediscounted paper other notes and securities of approximately the same face value as said rediscounted paper; that the Federal Reserve Bank continued to rediscount the paper of The Neoga National Bank and in like manner as aforesaid continued the requirement of collateral security up to the date of closing the said The Neoga National Bank when the amount of said loan to The Neoga National Bank was approximately $51,000.00 and that during all this period the Federal Reserve Bank was continuously making criticism of the banking methods of The Neoga National Bank and was continuously criticising the class of paper furnished it for loans by the Federal Reserve Bank and at the time of closing said The Neoga National Bank the Federal Reserve Bank had required the deposit with it of more than $120,000.00 in face value of the notes and paper of The Neoga National Bank to secure its loan of $51,000.00 and that in constantly requiring said additional collateral said Federal Reserve Bank notified the Board of Directors of The Neoga National Bank of the worthlessness and unsatisfactory nature of thenotes and papers of said Neoga National Bank and in order to properly secure itself the Federal Reserve Bank required collateral or more than double the amount of the loan to The Neoga National Bank because same were to a large extent worthless and not properly secured; that at the time of the closing of the said Neoga National Bank it had on deposit as a reserve fund with theFederal Reserve Bank approximately $10,000.00 which was approximately all the available cash The Neoga National Bank had at that time; that during all the time aforesaid the Federal Reserve Bank made no examination as required by law of The Neoga National Bank so far as your orators are advised; that the Federal Reserve Bank of Chicago being so organized under the laws of the

United States with full power to examine member banks as aforesaid had also the full and free access to all information acquired by the Comptroller of the Currency and the National Bank Examiners as to said The Neoga National Bank in the transaction of its business with said The Neoga National Bank and was also authorized to engage in the private banking business of rediscounting paper for its member banks for profit and was then and there a governmental agency organized for the purpose of supervising and improving the banking facilities of all its member banks and for the protection of the public; that by reason of the powers conferred upon said Reserve Bank as aforesaid it was the duty of said Reserve Bank to know the actual condition of the affairs of said The Neoga National Bank and it was then and there the duty of said Reserve Bank not to permit the depositors of said The Neoga National Bank to suffer loss by any act of said Federal Reserve Bank and it became therefore a trustee for your orators when it began and continued to rediscount the bills and papers of The Neoga National Bank since said rediscounting merely increased the indebtedness of said The Neoga National Bank; and that it reduced the assets thereof and thereby caused further loss to your orators and that it was the duty of said Federal Reserve Bank then and there having full power or supervision of The Neoga National Bank to have made an examination of the said Neoga National Bank and to have known of its insolvency before it discounted such papers and to have either caused The Neoga National Bank to be closed or to have refused to make said rediscounts and thereby prevented loss to your orators; and said Federal Reserve Bank would have known of the insolvency of said The Neoga National Bank if it had exercised ordinary care in the performance of its duties then and there owing to your orators."

Paragraph 24, on page 21, is as follows:

"And orators further represent that the Federal Reserve Bank of Chicago, by reason of the powers conferred upon it by law, had full and complete supervision of the affairs of said The Neoga

National Bank since the year 1921, and during that time was informed, or in the exercise of ordinary care in the performance of its duties of supervision should have been informed of the actual financial condition of said Bank and should have ascertained whether said Bank had sustained losses and was insolvent, and should have ascertained the negligence of the Directors and officers of said Bank in and about their duties, and should have known that said Bank was totally insolvent on the first day of January, 1924 up to the date of its closing as aforesaid, and that during all the time of said insolvency your orators and other creditors of said Bank were making deposits in said Bank, and should have ascertained that said Directors were fraudulently holding out said Bank to the public and to your orators after January 1, 1924, as a financially sound and solvent institution, yet said Federal Reserve Bank of Chicago having such knowledge as aforesaid, and being informed, or in the exercise of ordinary care in the performance of its said duties, being fully advised as to the insolvency of said Bank and of the negligent conduct of the officers and directors of said Bank, approved and confirmed the keeping open of said Bank as a solvent and sound financial institution as hereinbefore set forth, and thereby abetted and approved the negligent and fraudulent conduct of the officers and directors of said Bank in keeping said Bank open and in addition thereto, said Federal Reserve Bank, knowing the insolvent condition of said The Neoga National Bank and knowing that said Bank did not have funds of its own with which to reduce its indebtedness to said Federal Reserve Bank without using the funds deposited by your orators and other depositors in said Bank in the daily transaction of their business, required said The Neoga National Bank to continue to reduce its indebtedness to said Reserve Bank by using the moneys deposited by your orators and other depositors in The Neoga National Bank; that by reason of the powers conferred by Law upon said Federal Reserve Bank under the facts in this case, the said Federal Reserve Bank became and was a trustee for the depositors of The Neoga National Bank, and

> was burdened under the law with the duty of protecting the depositors of said The Neoga National Bank from any loss due to any act of said Federal Reserve Bank; and that by reason of the said Federal Reserve Bank cooperating with the officers and directors of said Bank in their negligent and fraudulent conduct of said Bank, your orators and other depositors in said Bank have sustained losses in excess of 40 percent. of the deposits made by your orators and other depositors in said Bank during said time, which said deposits of your orators is set forth in Paragraph 22 hereof."

The foregoing are all of the provisions in the bill of complaint dealing with the subject of the alleged duties of the Federal Reserve Bank to the complainants. Disregarding for the moment the action of the Federal Reserve Bank after the insolvency of the Neoga Bank, we now ask:

Do the foregoing allegations constitute a cause of action against the Federal Reserve Bank of Chicago?

Restating the effect of the foregoing averments, they charge that the Federal Reserve Act required the Neoga National Bank to be a member of the Federal Reserve Bank of Chicago, when extending credit to the Neoga Bank, to supervise and examine its business in like manner to the supervision and examination exercised by the Comptroller of the Currency. That the directors of the Neoga Bank were constantly required to make reports of its financial condition to the Comptroller of the Currency and to the Federal Reserve Bank of Chicago. That the Federal Reserve Bank of Chicago redis-

counted paper of the Neoga National Bank in varying amounts, demanded security therefor, complained of the quality and character of the paper tendered by Neoga Bank for rediscounting, and ultimately had in its hands as security for such loans substantially all of the assets of the Neoga Bank of any substantial value. That the directors of the Neoga National Bank made false and misleading reports of its condition to the Comptroller of the Currency. That the Federal Reserve Bank of Chicago had full and complete authority, with the approval of the Federal Reserve Agent, to make special examinations of the Neoga Bank by reason of its discount of its paper, but that the Federal Reserve Bank of Chicago continued rediscounting Neoga Bank paper and demanding security for each rediscounting loan and at the same time criticized the class of paper tendered, and so had knowledge that the affairs of the Neoga National Bank were in doubtful condition. That had the Federal Reserve Bank of Chicago made further examinations, it would have discovered that the directors of Neoga Bank were fraudulently holding that institution out to the complainants as a solvent institution, but that the Federal Reserve Bank of Chicago being advised of the insolvency of the Neoga Bank and of the negligent conduct of its officers and directors approved and confirmed the keeping open of said bank as a solvent and sound financial institution

and thereby abetted and approved the negligent and fraudulent conduct of its officers and directors.

It is clear that these averments do not state a cause of action against the Federal Reserve Bank of Chicago unless it was the duty of Federal Reserve Bank to cause examinations of the affairs of Neoga Bank, and, as the result of such examination, to take some action upon a showing of insolvency, but this we have shown in the foregoing not to be true. The whole duty, and indeed, the exclusive power to make such examinations and take such disciplinary action with regard to the Neoga Bank is by statute imposed upon the Comptroller of the Currency. There were only two ways in which the Neoga National Bank could have been declared to be insolvent. They are both set forth in U.S.C.A., Title 12, Sec. 191. They are that any creditor having obtained a judgment against the Neoga Bank might make application to the Comptroller of the Currency, accompanying his application by a certified copy of the judgment showing it to have remained unsatisfied for thirty days and upon such application the Comptroller would appoint a Receiver; and the second method would be that the Comptroller should have himself become satisfied of the bank's insolvency after an examination of its affairs.

If the Federal Reserve Bank of Chicago had made an examination or had in any other manner become satisfied of

the insolvency of the Neoga Bank, it would have had no right to declare that fact or to make any application to the Comptroller to declare it without first having put itself into the same position as any other creditor by securing a judgment against the Neoga Bank and sending a certified copy of such unsatisfied judgment to the Comptroller with its application.

The Federal Reserve Bank of Chicago had the right, under some circumstances, to make supplemental examinations of the Neoga National Bank for its own information in the extension of credit and for the protection both of the public interest and of the interest of the other member banks in the Federal Reserve Bank of Chicago, but if in the course of such examinations it had come to the conclusion that the Neoga National Bank was insolvent and had called its belief to the attention of the Comptroller of the Currency and the Comptroller had come to a different conclusion, the Federal Reserve Bank of Chicago, like any other individual, would have been foreclosed and estopped by the official determination of the Comptroller of the Currency to whom alone the power to determine that fact is committed.

As a matter of fact the theory of the allegations, which are now being considered, is a total misconception of the function of the Federal reserve bank toward its member banks. The Federal Reserve Act creates the Federal Reserve

System to be of assistence to member banks, not so much for the benefit of the member banks, as for the benefit of the entire fiscal and financial situation in the country, and practice under the Federal Reserve Act shows that this purpose has from the first been understood and followed. Member banks temporarily in trouble go to the Federal reserve banks to aid them to tide over their temporary difficulties and the Federal reserve bank brings to the support of an embarrassed member the aggregated strength of the District. Every consideration of wisdom and policy approves the action of Congress in thus excepting the disciplinary control of national banks from the Federal reserve banks, whose duty it is to prevent bank failures, not to bring them about, to go perhaps beyond the lengths of prudence and forbearance in the aid of weak members in order, if possible, to avert the necessity of ultimate failure. All the provisions of the Federal Reserve Act itself show that this was the purpose of Congress, but in order to leave no doubt about it, the Federal Reserve Act itself contains specific references to the official examinations of member banks by the Comptroller. Thus in U.S.C.A. Sec. 482, the Federal Reserve Board is given power, upon the recommendation of the Comptroller of the Currency, to fix the salaries of bank examiners, but the initiative here lies with the Comptroller. In U.S.C.A., Sec. 483, the power to make special

examination is given to the Federal reserve banks, but these special examinations are, by the language of the statute, in addition to examinations made and conducted by the Comptroller of the Currency and the Federal reserve bank may not make these special examinations without first having the approval of the Federal reserve agent or the Federal Reserve Board, and then, in order to prevent any possible misconstruction, U.S.C.A. Sec. 484 provides that no bank shall have any visitorial powers other than such as are authorized by law or vested in the courts, or shall be, or have been, exercised by either House of Congress or any committee thereof.

To establish a cause of action against the Federal Reserve Bank of Chicago in this behalf, it would be necessary to show that the Federal Reserve Bank was under a duty to the complainants which it had negligently failed to perform. There being no such duty, there can be no such delict as is alleged.

2. The Action of Federal Reserve Bank of Chicago After the Insolvency of the Neoga National Bank.

The allegations in the petition with regard to the conduct of the Federal Reserve Bank of Chicago after the insolvency of the Neoga Bank manifestly have nothing to do with the wrongful acts and neglects alleged against the directors and officers of the Neoga Bank. The allegations in

question are as follows:

Paragraphs 18 and 19 of the bill, page 17, are as follows:

"Orators further represent that when The Neoga National Bank closed its doors on January 12, 1925, the said Federal Reserve Bank took unto itself all the rediscounts and collateral on deposit with it amounting to approximately $120,000 and the reserve fund on deposit with it amounting to approximately $10,000 and the stock in the said Federal Reserve Bank of the approximate value of $1000.00 and kept and paid itself in full therefrom and turned the balance of said collateral and rediscounts over to the Receiver thereby making itself a preferred creditor of The Neoga National Bank; that the transfers of the notes and bills of The Neoga National Bank to the said Federal Reserve Bank were all made after the said Neoga National Bank became insolvent and after such insolvency would have become known to the Federal Reserve Bank if it had used ordinary care in and about the performance of its duties owing to the public and that under the Federal Banking Laws such transfers were utterly null and void as against your orators and that the Federal Reserve Bank should be required to turn over to the Receiver all the funds, notes and bills in its hands on January 12, 1925, and should be put on the same basis as any other creditor of said Bank; and that being so advised as to the conditions of the affairs of The Neoga National Bank the said Federal Reserve Bank of Chicago, connived, consented and cooperated with the directors and officers of The Neoga National Bank thereby permitting the manipulation of the deposits of said Bank, the management and control of said bank to the injury and damage of your orators and thereby committed a fraud upon your orators and other depositors.

"19. Orators further represent that at the time of closing said Bank your orators and other depositors had on deposit approximately $116,381.46; that the loans and discounts owned by said Bank had a face value of $170,655.88 and over-drafts amounting to $1881.45 and had other assets amounting to

> $38,430.79 which should have been applied to the payment of your orators; that the said Directors permitted the Federal Reserve Bank to pay itself in full the sum of approximately $51,000 out of said assets as a preferred creditor of said Bank; that the said Federal Reserve Bank having full knowledge of the situation and of the affairs of The Neoga National Bank under the National Banking Laws had no authority or right to make itself a preferred creditor, yet the Receiver of said Bank and the Directors stood by and abetted the said Federal Reserve Bank in taking advantage of its own wrong and permitting it to be paid in full and depriving your orators and other depositors of said Bank of a fair, just and equal distribution of the assets of said Bank and that in equity and in good conscience the Federal Reserve Bank of Chicago should be compelled as a trustee under the circumstances to pay over to the Receiver of said Bank the said sum of approximately $51,000 and should be made amenable to the law as other creditors of said Bank and that the said Directors of said Bank should be required to make good to your orators and other depositors their pro rata share of said $51,000."

The net effect of these averments is that after the Neoga National Bank closed its doors, through the action of the Comptroller, the Federal Reserve Bank of Chicago appropriated the stock of the Neoga Bank in the Chicago Bank of the value of $1000.00, the reserve fund of the Neoga Bank amounting to $10,000.00 and so much as was necessary of the collateral in its hands securing rediscounts to pay the debts of the Neoga Bank to the Federal Reserve Bank, and returned the balance in its hands to the Receiver of the Neoga Bank. The allegations that the Federal Reserve Bank of Chicago

connived, consented and cooperated with the directors and officers of the Neoga Bank to secure a preference is, of course, a conclusion of law flatly at variance with the facts pleaded. The Federal Reserve Bank of Chicago was not, and did not become, a preferred creditor. It was and remained a secured creditor.

It is not alleged in the bill of complaint, and could not have been, that the Federal Reserve Bank of Chicago secured any of the resources of the Neoga National Bank as an unlawful preference. All the assets of the Neoga Bank in its hands came into its possession in due course for value received and pursuant to law. Thus the $1000.00 invested in the capital stock of the Federal Reserve Bank of Chicago was an investment required to be made by a member bank, the reserve funds of the Neoga National Bank were deposits required to be made by law for specific purposes and to be administered in furtherance of those purposes. The securities for loans similarly were required to be exacted by the Federal Reserve Board of Chicago by the law which authorized those loans.

The application by the Federal Reserve Bank of Chicago of the assets of the Neoga Bank in its hands to the payment of the debts due to it was necessary ~~to~~ carry out the purpose of the Federal Reserve System. If the Federal Reserve Bank of Chicago had returned all these assets to the Receiver and had

become merely a general creditor of the Neoga Bank, the loss sustained would have been a loss to the other member banks of the Federal Reserve Bank of Chicago, since all the resources of the Federal Reserve Bank of Chicago belonged to the member banks and are made up of their investments in its capital stock and their reserve deposits. The plain purpose of the Federal Reserve Act is to accumulate these resources of the members to make them available to the members under conditions of safety and security. If the Federal reserve banks were required to sustain losses in these resources in the manner suggested by the bill of complaint, then instead of being a source of strength to the financial structure of the country, the Federal reserve banks would be a source of weakness, as every such loss would pro tanto affect the strength of all member banks and thus spread the consequences of local loss throughout the whole structure. This idea was suggested to the Congress in the amendment proposing a guarantee of deposits in member banks through the Federal reserve banks but was rejected as being at variance with the purpose of the Federal Reserve System.

Dealing specifically with the three items of assets of the Neoga National Bank, we take up first:

Federal Reserve Bank of Chicago was Entitled to Appropriate the Stock Interest of the Neoga Bank.

Section 6 of the Federal Reserve Act (U.S.C.A., Title 12, Ch. 3, Sec. 288) provides:

> "If any member bank shall be declared insolvent and a Receiver appointed therefor, the stock held by it in said federal reserve bank shall be cancelled without impairment of its liability, and all cash paid subscriptions on said stock, with one-half of one per centum per month from the period of last dividend, not to exceed the book value thereof, shall be first applied to all debts of the insolvent member bank to the Federal reserve bank and the balance, if any, shall be paid to the Receiver of the insolvent bank."

It will be observed that in the foregoing quotation from the statute, this application of paid subscriptions to capital stock is made mandatory by the use of the word "shall". The Supreme Court of the United States in Farmers & Merchants Bank of Monroe v. Federal Reserve Bank of Richmond, 262 U.S. 649, says, at page 663:

> "This statute appears to have been drawn with great care. Throughout the Act the distinction is clearly made between what the Board and the reserve banks 'shall' do and what they 'may' do."

The subscriptions to the capital stock of the Federal reserve banks by national banks are made mandatory by the Federal Reserve Act (U.S.C.A. Title 12, Ch. 3, Sec. 282) and the amount is fixed at a sum equal to six per centum of the paid up capital stock and surplus of each member. In view of these requirements of the Federal Reserve Act, the

Federal Reserve Bank of Chicago had no alternative and the complainants must be held to have dealt with the Neoga Bank with knowledge of its investment in the capital stock of the Federal Reserve Bank of Chicago, and the preference created by law in favor of the Federal Reserve Bank of Chicago to the extent of any indebtedness to it by the Neoga National Bank.

The Federal Reserve Bank of Chicago was Entitled to Set Off Against the Reserve Fund of the Neoga Bank any Indebtedness due It from that Bank.

The second asset item of the Neoga National Bank as to which complainants complain had to do with "the reserve fund on deposit with the Federal Reserve Bank of Chicago amounting to approximately $10,000.00."

Reserve funds in Federal reserve banks deposited under Section 19 of the Federal Reserve Act (U.S.C.A. Ch. 3, Sec. 462) constitute a credit balance. The member bank deposits checks and other items with the Federal reserve bank daily to the credit of this account and draws its own checks on its balance in the transaction of its daily business. By statute (U.S.C.A. Ch. 3, Sec. 464) this balance is made subject to be checked against and withdrawn by the member bank for the purpose of meeting existing liabilities. It was, therefore, like an ordinary account maintained in a bank by a depositor.

Neoga Bank could have drawn a check upon it any day to pay any indebtedness from it to the Federal Reserve Bank of Chicago and, on the declaration of the insolvency of Neoga Bank, this fund in the hands of Federal Reserve Bank of Chicago was subject to an ordinary banker's lien to be set off against any indebtedness from the Neoga Bank to it. The law is entirely well settled that a bank upon the insolvency of its depositor may apply the balances remaining on deposit in open accounts in payment of obligations due it from such depositor. A Federal reserve bank is in effect a banker's bank and the relationship between it and its members is in many respects similar to the relation existing between an ordinary bank and individual depositors. The rule with regard to banker's liens, more properly a right of set-off, is not peculiar to banks but is an outgrowth of the general doctrine of set-off and has been repeatedly recognized by the State and Federal courts alike both where the depositor was an individual and where the depositor was a bank.

Scott v. Armstrong, 146 U.S. 499.
Studley v. Boylston Bank, 229 U.S. 523.

The latter of these cases arose in a bankruptcy proceeding, but the Supreme Court specifically recognized that the right was not created by the Bankruptcy Act, but was an outgrowth of set-off. (See page 528).

A similar case, Federal Reserve Bank of Minneapolis v. First National Bank of Eureka, 277 Fed. 300 (1921), arose from the closing of a national bank by the Comptroller of the Currency. A Receiver had been appointed and the Federal Reserve Bank insisted upon its right to cancel the member's stock and apply that and the reserve deposit of the member bank to the payment of the member bank's obligations. These obligations arose by the endorsement of paper of the member bank for rediscount. It was contended on behalf of the Receiver that the Federal Reserve Bank must first exhaust the makers of the paper and assert only a secondary liability against the member bank. The court, however, held that the object of the Federal Reserve Act was at all hazards to secure the Federal reserve banks and that endorsement for rediscount by a member bank constituted a primary liability and approved the action of the Federal Reserve Bank in applying the reserve balance and the proceeds of the member's stock immediately and without first exhausting the makers of the paper. On page 302 the court says:

> "If the purpose and intent of the statutes and rules and regulations above referred to are to be recognized, it is the evident intent and purpose to protect the bank in its service, and the advancement of funds to member banks, and upon the receipt of the notes of the bank and collateral notes with the endorsement of the bank."

The court here recognizes the distinction which we have pointed out above. The function of Federal reserve banks is to aid, nurse and, if possible, save member banks. Every safeguard is thrown around their performance of this function. It is not required to be performed at the hazard of its own resources, which are, after all, the resources of its other member banks. It has no general visitorial or disciplinary function. Per contra, the visitorial and disciplinary power of the Government is vested in the Comptroller of the Currency and in him alone.

Federal Reserve Bank of Chicago Was Entitled to Retain and Apply the Collateral Which It Had Received for Rediscounting of Paper.

The 18th and 19th paragraphs of the amended bill allege repeatedly that the Federal Reserve Bank has made itself a preferred creditor. The facts alleged by the bill, however, are that the Federal Reserve Bank was a secured creditor as to the collateral demanded and received by it to protect loans made to the Neoga Bank.

Paragraph 18 of the amended bill alleges that the Federal Reserve Bank, after satisfying the indebtedness to it of Neoga Bank, turned the balance of the collateral and rediscounts over to the Receiver of the Neoga Bank.

The matter of rediscounts is covered in Section 13 of the Federal Reserve Act (U.S.C.A. Ch. 3, Sec. 343) which

provides:

> "Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may discount notes, drafts, and bills of exchange, arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this chapter."

By the provisions of Sections 344 and 346, additional authority is given to discount other forms of paper, including acceptances, and by Section 347, it is provided:

> "Any Federal reserve bank may make advances to its member banks on their promissory notes for a period not exceeding fifteen days at rates to be established by such Federal reserve banks, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this chapter, or by the deposit or pledge of bonds or notes of the United States."

Limitations are imposed upon this power by Section 352 and provision is made for the regulation of the rediscount rate from time to time. This latter is one of the vital powers in the Federal Reserve Act. Through it the Government controls the tendency to speculation and regulates

in the public interest the availability of loan money.

It is very important, further, to note that the provision of elasticity in the currency was one of the great objects in the Federal Reserve Act, and that this object was accomplished by the authorization of Federal reserve notes. These notes constitute now a large part of our currency. They are protected by the deposit with the Federal reserve agent as collateral security of paper rediscounted by the Federal reserve banks, so that it is of the very highest importance that rediscounted paper should be fully protected by the most adequate security.

In Section 16 of the Federal Reserve Act (U.S.C.A., Ch. 3, Sec. 412) it is provided:

> "Any Federal reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application. ********The said Federal Reserve Board may at any time call upon a Federal reserve bank for additional security to protect the Federal reserve notes issued to it."

It was, therefore, not only the right, but the plain duty, under this statute of the Federal Reserve Bank of Chicago to demand, receive and hold collateral, which, in its judgment, fully protected rediscounted paper of Neoga National

Bank. Resultantly Federal reserve notes based upon the rediscount paper have entered into the general currency of the country and the solvency of rediscounted paper is the basis upon which Federal reserve currency rests.

It thus appears that in all three of the matters complained of, the Federal Reserve Bank of Chicago acted within the plain language or necessities of the statute. The Neoga National Bank secured value received for all of its assets in the hands of the Federal Reserve Bank of Chicago and those assets were applied in accordance with the obligations of the Neoga National Bank, all of which were created by law and were, therefore, known to depositors in the Neoga Bank.

In the foregoing we have demonstrated that the Federal Reserve Bank of Chicago was guilty of no breach of duty toward the complainants, but, on the contrary, acted in accordance with the law in all respects. It is, therefore, respectfully submitted that the amended bill does not state a cause of action against the Federal Reserve Bank of Chicago.

II.

THERE IS A MISJOINDER OF CAUSES OF ACTION IN THE AMENDED BILL

We have shown in the foregoing pages that no cause of action is stated in the amended bill against the Federal Reserve Bank of Chicago, but, apart from those questions, we submit that there is an improper joinder of the causes of action against the officers and directors of the Neoga Bank on the one hand and those supposed to exist against the Federal Reserve Bank of Chicago on the other.

We have seen that the bill asserts the liability of the Federal Reserve Bank of Chicago upon two distinct theories which we have discussed in detail. These are:

1. That there was a breach of duty growing out of the negligent or careless failure on the part of the Federal Reserve Bank of Chicago to examine the Neoga Bank.

2. That the Federal Reserve Bank of Chicago was guilty of some wrong, because of the action taken by it after the insolvency of the Neoga bank in appropriating the assets in its hands.

On the other hand, there are two distinct causes of action stated against the officers and directors of the Neoga Bank, which may be briefly summarized as follows:

1. The negligent administration of the affairs of the bank by the directors caused the bank to become insolvent and the plaintiffs will lose a part of their deposits.

2. The Neoga Bank was kept open and received deposits from plaintiffs after the directors

knew, or should have known, that the bank was insolvent.

Bearing in mind the distinct character of the four claims made by the amended bill, let us examine the standards which have been established by the Federal Courts for determining questions of misjoinder or multifariousness. Since February 1, 1913, the new equity rules adopted by the Supreme Court have controlled the practice on the equity side of the Federal Court. Rule 26 deals specifically with joinder of causes of action and reads as follows:

"Rule 26. Joinder of Causes of Action.

The plaintiff may join in one bill as many causes of action, cognizable in equity, as he may have against the defendant. But when there are more than one plaintiff, the causes of action joined must be joint, and if there be more than one defendant the liability must be one asserted against all of the material defendants, or sufficient grounds must appear for uniting the causes of action in order to promote the convenient administration of justice. If it appear that any such causes of action cannot be conveniently disposed of together, the court may order separate trials."

This rule, although it had no prototype in the eariler rules of the Supreme Court, did not establish a new standard for determining questions of misjoinder or multifariousness, but was rather a crystalization of those rules or criteria which had been developed and applied over a long period of time by the Federal courts. Thus, in Low v. McMaster, 255 Fed. 235, 236, the court recognized that the rule did not

establish a new basis and held that it did not prohibit any joinder of causes of action which was permissible before its passage. In view of this holding, it will be interesting to examine cases decided before as well as after the promulgation of Rule 26.

Almost half a century ago, the Supreme Court, speaking through Mr. Justice Miller, defined multifariousness in an opinion which has been frequently cited and quoted since that time.

Walker v. Powers, 104 U. S. (14 Otto), 245.

The Court said, page 251:

> "By multifariousness 'is meant the improperly joining in one bill distinct and independent matters, and thereby confounding them; as, for example, the uniting in one bill of several matters, perfectly distinct and unconnected, against one defendant or the demand of several matters of a distinct and independent nature against several defendants in the same bill.' Story, Eq. Pl., sect. 271. In Daniell's Chancery Practice, 335, it is said in explanation of this that 'it may be that the plaintiffs and defendants are parties to the whole of the transactions which form the subject of the suit, and, nevertheless, those transactions may be so dissimilar that the court will not allow them to be joined together, but will require distinct records.'"

The Circuit Court of Appeals for this circuit has had occasion to pass upon a question of misjoinder in a situation which was in many respects similar to that now before the court. In Watson v. U. S. Sugar Refinery, 68 Fed. 769 (C.C.A. 7th Circuit 1895), the bill asked for dissolution of a corporation and an accounting upon various grounds and also

sought to recover judgment against certain individual defendants on the ground that complainant had been induced by false representations to purchase stock in the corporation. The court held that there was a misjoinder of the causes of action and that the cause of action against the corporation was entirely distinct from that alleged against the individuals for false representations and said (page 772):

> "If the appellant was induced by false representations to make a losing investment in the corporate stock, his remedy is at law against those who deceived him, and not against the corporation. * * * * * Unless, therefore, the averments in respect to the deceit practiced upon him be rejected as meaningless or superfluous, the bill is clearly multifarious, not only because it joins distinct and independent matters, but because it seeks to enforce different remedies against distinct parties not jointly liable or interested."

The rule laid down in the Sugar Refinery Company case by the Circuit Court of Appeals for this circuit has been recognized by the courts of appeals in other circuits and has been applied since the adoption of the new equity rules.

Watson v. Huntington, 215 Fed. 472, C. C. A. 2nd Circuit, (1914).

The decision of the court is shown by the syllabus:

> "A bill by stockholders of a corporation to recover damages from the defendant on the ground of his fraudulent acts as an officer of the corporation by which, as alleged, certain of the complainants were induced to purchase their stock, and others, who had previously purchased, were otherwise injured, is bad for multifariousness; the right to relief of the two groups being based on a different state of facts."

Backus v. Brooks, 195 Fed. 452, C.C.A. 2nd Circuit, (1912).

The decision of the Court is shown by the syllabus:

> "A bill in equity which states a cause of action in behalf of individual complainants based on the fraudulent conduct of majority stockholders toward the minority, and which asserts the right of stockholders to follow corporate property conveyed in fraud, and which states a cause of action in favor of a corporation, as complainant, for breach of contract by defendant corporation and individual defendants for the purchase of articles, is multifarious for misjoinder of causes of action."

Price v. Union Land Co. 187 Fed. 886, C. C. A. 8th Circuit (1911).

The decision of the court is shown by the syllabus:

> "A right to maintain a suit against the officers of a corporation for fraudulent misappropriation of its property is a right of the corporation, and stockholders suing in such right cannot join therewith a cause of action for fraud and deceit practiced on them when they purchased their stock which is personal."

The court said, page 889:

> "But running through the bill is an attempted assertion of a cause of action against the individual defendants not for the use and benefit of the Fuel Company but exclusively affecting the complainants as individuals. It is for fraud and deceit practiced upon them in the original sale and purchase of the stock which they hold. Clearly such a cause of action has no place in a stockholders' suit brought for the benefit of the corporation. 'A right to maintain a suit against the officers of a corporation for fraudulent misappropriation of its property is a right of the corporation.' Porter v. Sabin, 149 U. S. 473, 478, 13 Sup. Ct. 1008, 37 L.Ed. 815. A right of a stockholder to sue for fraud and deceit practiced upon him when he purchased stock is a personal one."

In view of Rule 26 and the foregoing authorities, it appears that there are three distinct reasons why a bill may be multifarious.

1. Misjoinder of parties plaintiff.

2. Misjoinder of parties defendant.

3. Misjoinder of causes of action.

The present bill is objectionable upon all three of these grounds, and we will examine it separately with respect to each.

1. MISJOINDER OF PARTIES PLAINTIFF:

As to the joinder of parties plaintiff, Rule 26 provides:

> "But when there are more than one plaintiff the causes of action joined must be joint."

The second cause of action which the will alleges against the officers and directors of the Neoga bank (i.e., the wrongful receipt of deposits after insolvency), is clearly one in which the plaintiffs are suing in their individual capacities. Indeed, there are actually as many causes of action against the individual directors of the Neoga bank as there are plaintiffs. It is evident that the acceptance of deposits by the directors from the various plaintiffs when the Neoga bank was insolvent was not an injury to the corporation, the Neoga bank, but was only an injury to the individual depositors whose money was wrongfully accepted.

Cassidy v. Uhlmann, 170 N. Y. 505, 63 N. E. 554

It is possible that the first claim attempted to be asserted against the Federal Reserve Bank of Chicago (i.e., the breach of duty to examine and superintend the Neoga bank) is also an individual claim of the various depositors. We have pointed out that the Federal Reserve Bank had no such duty as is claimed by the amended bill, but if there were such a duty, we could not determine the party aggrieved by a breach thereof without knowing whether the duty was owing to the Neoga bank or the depositors of such bank or the public at large.

On the other hand, the first claim against the officers and directors of the Neoga bank (i. e., for negligence), and the second claim against the Federal Reserve Bank (i.e., for appropriating the security in its possession after the receivership), are undoubtedly rights which were vested in the corporation and which the Receiver could have asserted. The plaintiffs' only right to sue, therefore, must depend upon the fact that they have made a demand upon the Receiver to commence suit and that he has refused. Thus, we have the plaintiffs as to at least one cause of action suing in their individual capacities and in at least two other causes of action suing merely in their representative capacities, because the directors or the receiver who should compel action by the corporation have failed to act. The situation thus presented is within the rule laid down in Watson v. Huntington, Backus v. Brooks

and Price v. Union Land Co., cited above.

2. MISJOINDER OF PARTIES DEFENDANT:

As to the misjoinder of parties defendant, Rule 26 says:

> "If there be more than one defendant, the liability must be one asserted against all of the material defendants."

The mere statement of this rule and the enumeration of the various causes of action included in the bill makes it clear that there is a misjoinder. The Federal Reserve Bank of Chicago is not, of course, jointly liable with the directors, either because of the directors' negligence or because deposits were wrongfully received after the insolvency of the Neoga bank, and, on the other hand, the officers and directors of the Neoga bank are not liable, either for the breach of the supposed duty of the Federal Reserve Bank to examine and superintend the Neoga bank or for the appropriation of the security by the Federal Reserve Bank after the receivership. There are, to be sure, some allegations in the nineteenth paragraph of the amended bill which suggest that the directors and officers connived and cooperated with the Federal Reserve Bank in appropriating the security in question, but inasmuch as this was not done until after the receivership, it must be clear that these allegations which are merely in the form of conclusions are entirely inconsistent with the specific facts alleged by the complainant.

3. MISJOINDER OF CAUSES OF ACTION:

Rule 26 contains an additional provision which may justify a joinder of defendants which would otherwise be improper. It reads:

> "or sufficient grounds must appear for uniting the causes of action in order to promote the convenient administration of justice."

What are the grounds which "must appear" to justify the joinder? The criterion which had been established by the Federal Courts prior to the adoption of Rule 26 and which has been applied constantly since that time, is that there are such grounds for uniting causes of action only when there is such identify of issues either of fact or of law which will be decisive of the various causes of action, that the convenience of the parties and of the court will be served by determining those issues at one time rather than in distinct trials. It is, therefore, necessary to consider this part of the rule in connection with the discussion of misjoinder of causes of action. As stated by the Supreme Court in Walker v. Powers (supra, page 41), multifariousness means:

> "The uniting in one bill of several matters, perfectly distinct and unconnected, against one defendant, or the demand of several matters of a distinct and independent nature against several defendants in the same bill."

Bearing in mind this rule, we can most effectively demonstrate the futility of consolidating in one case the claims against the Federal Reserve Bank of Chicago and the

claims against the directors of the Neoga Bank by enumerating the issues which are involved in each case and thus determining what, if any, common points of litigation there are in the two cases.

The case against the Federal Reserve Bank of Chicago, if there is a case, involves the following questions:

1. The right of a Federal reserve bank to cancel the stock of an insolvent member bank and apply the value thereof to the debts of the insolvent member bank to the Federal Reserve Bank, as provided for in U. S. C. A. Title 12, section 288.

2. The right of a Federal reserve bank to assert a lien or set-off on the reserve deposit of an insolvent member bank.

3. The right of a Federal reserve bank to apply the discounted paper and collateral received from an insolvent member bank in payment of the obligations of the member bank which such paper was given to secure.

4. Whether the Federal Reserve Bank had any actual knowledge of the condition of the Neoga Bank.

5. Whether the Federal Reserve Bank was chargeable as a matter of law with notice of the condition of such bank.

6. Whether, if the Federal Reserve Bank had knowledge either as a matter of fact or as a matter of law, such knowledge makes any difference in the liability of such Federal

Reserve Bank.

7. Whether the plaintiffs in this case, as depositors, actually suffered any damage through dealings between the Neoga bank and the Federal Reserve Bank.

8. What, if any, duties a Federal reserve bank owes to the depositors of member banks to protect such depositors against misfeasance, malfeasance or nonfeasance of the directors and officers of such member bank?

9. If there is such a duty, whether there was any failure on the part of the Federal Reserve Bank to perform that duty in the present case.

10. If there was such a duty and a failure to perform it, whether the Neoga Bank, or its depositors, suffered any damage of which such failure was the proximate cause.

It is clear that no one of these issues is at all material in determining the liability of the directors and officers of the Neoga Bank to the plaintiffs in the present case.

On the other hand, the case against the directors of the Neoga Bank involves, among others, the following questions:

1. The knowledge or lack of knowledge of each of the nine directors as to the condition of the Neoga Bank at various times from 1921 to January 1925.

2. The participation or lack of participation in the

affairs of the Neoga Bank of each of the nine directors.

3. The extent to which the directors, as a matter of law, are chargeable with knowledge of the affairs of the bank.

4. Whether the directors kept the affairs and books of the bank in such condition that they could easily ascertain its condition.

5. Whether failure to keep the affairs and books of the bank in such condition that the directors could be easily advised of its solvency or insolvency, amounted to negligence on the part of the officers or directors.

6. Whether various loans made by the bank and approved by the directors were improper because of the inadequacy of the security received by the bank.

7. Whether various loans made by the bank and approved by the directors were improper because of the character of the individuals who made the loans.

8. Whether excessive loans were made to particular people in view of the size of the bank, the funds available for loans and the responsibility of the borrower.

9. Whether false reports, as alleged in the amended bill, were made by the directors and resulted in misleading the depositors and the Comptroller of the Currency.

10. Any other facts and circumstances whatsoever which may tend to show the negligent management of the affairs of the bank by its officers and directors.

11. Whether the Neoga Bank was insolvent when deposits were received from the various plaintiffs.

12. Whether each or any of the directors acted improperly in view of his knowledge, actual or constructive, of the affairs of the bank, in continuing to operate the bank and receive deposits during the year 1924.

We submit that no one of these issues is at all material in determining the liability of the Federal Reserve Bank to the plaintiffs in the present case.

It is submitted, in view of the foregoing enumeration, that the uniting of the causes of action against the directors on the one hand and the Federal Reserve Bank on the other would not serve to promote the convenient administration of justice, but would be a serious inconvenience to the court and the parties concerned in disposing of the several entirely distinct controversies attempted to be set forth in the amended bill.

CONCLUSION

The fundament of the plaintiffs' claim is the misconduct and negligence of the officers of the Neoga Bank. Their wrongful acts are alleged to have injured the plaintiffs in two distinct ways:

1. The negligent management by the defendant directors caused the insolvency of the bank and the consequent loss to the depositors.

2. The defendant directors wrongfully continued to operate the bank and accept deposits from the plaintiffs after they knew or should have known that the bank was insolvent.

It must be clear that the Federal Reserve Bank of Chicago was not in any way involved in either of these breaches of duty toward the plaintiffs and there are no facts alleged in the amended bill showing that the Federal Reserve Bank was involved in the slightest degree. The claims which are made against the Federal Reserve Bank itself are unfounded in law, contrary to the express provisions of the Federal Reserve Act and the decisions of the Courts thereunder, and the motion of the defendant should be granted both on the ground that no cause of action is stated against the Federal Reserve Bank of Chicago and on the ground that there is a misjoinder of the causes of action set forth in the amended bill.

Respectfully submitted,

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Attorney for Federal Reserve
Bank of Chicago.

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of Counsel.