UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT

FRANK G. RAICHLE,

Appellant,

against

FEDERAL RESERVE BANK OF NEW YORK,

Appellee.

Before:

L. HAND, SWAN and AUGUSTUS N. HAND,
Circuit Judges.

Appeal from the United States District Court for the Southern District of New York.

Bill in equity by Frank G. Raichle to restrain the Federal Reserve Bank of New York from doing various acts in derogation of plaintiff's alleged rights. Upon motion by the defendant, in the nature of a demurrer, the bill was dismissed by the District Court, and plaintiff appeals.

This is an appeal from a decree dismissing a bill in equity upon the merits. The defendant moved to dismiss the bill on the ground:

1. That it appears on the face of the complaint by plaintiff's own showing that he is not entitled to the relief prayed for by this complaint against the

defendant, nor to any relief arising from the facts alleged in said complaint.

2. That it appears on the face of said bill of complaint that this court has no jurisdiction to hear and determine this suit.

3. That it appears on the face of said bill of complaint that said complaint is wholly without equity.

The bill alleges the incorporation of the defendant, which we shall hereinafter call the Bank, under the Act of Congress called the Federal Reserve Act. It alleges that this act was passed to "furnish an elastic currency, to afford means of discounting commercial paper and to establish a more effective supervision of banking in the United States"; that the Bank "is a unit in the Federal Reserve System, and as such has certain powers conferred upon it by the Federal Reserve Act and performs certain functions under the control of its Board of Directors and the Federal Reserve Board"; that the "Federal Reserve Board is by law vested with limited control over Federal Reserve re-discount facilities and the defendant Federal Reserve Bank of New York is vested with limited control over its own rediscount facilities."

After setting forth that the United States have for six years experienced great prosperity, that business conditions are good and getting better, that employment and wages are satisfactory, that the signs usually consulted indicate a continued improvement and that accordingly large numbers of people have invested in stocks and bonds of various industrial and railroad corporations, the bill goes on to say that the plaintiff owns various securities outright and has borrowed money to purchase others.

It further alleges that there is an abundance of credit readily available for the needs of industry and agriculture, as well as investment, but that the bank reports that brokers' loans have increased in volume and commercial loans have decreased. Such a condition is said to be due to the tendency of banks to charge high rates of interest and to make loans callable on demand and, by reason of these circumstances, it is said to have been found desirable to borrow money from the public through security offerings in order to eliminate banks as middlemen.

The bill then goes on to say that the credit available in the United States is in excess of fifty billion dollars and that the total of brokers' loans approximates only six and one-half per cent of this amount, so that the claim that too much of available credit is involved in collateral or brokers' loans is not justified.

The bill then sets up the wrongful acts on which the plaintiff founds his cause of action. It says that the Bank during the year 1928 illegally engaged in a course of conduct, which it is still continuing, that had for its object an arbitrary reduction of brokers' loans and a general reduction of security prices. The course of conduct consisted of the following acts:

> (1) "This defendant and the Federal Reserve System generally, ... wrongfully ... spread propaganda concerning an alleged money shortage and expressed alarm over the increasing volume of collateral loans, whereas no shortage exists other than one of their own making which is technical in its nature and artificial in its essence."

Many persons induced by this propaganda have sold securities thereby contributing to a decline in market prices and to plaintiff's damage.

> (2) "The defendant, ... and the Federal Reserve System generally, have ... wrongfully ... set about to restrict the supply of credit available for investment purposes and cause a general liquidation of security loans with a resultant reduction in quoted security prices. In this connection the defendant, ... and Federal Reserve System generally, have engaged in an open market operation, as the term is generally used by those concerned in this practice, but not for the purpose contemplated by the use of the term in the Federal Reserve Act. The defendant and other Federal Reserve banks have sold quantities of securities aggregating many millions of dollars ... for the sole purpose of taking money and its attendant credit out of the market and removing the same from use, thus curtailing credit and causing an artificial money shortage to the plaintiff's damage and injury. This conduct ... is not justified by any economic circumstances, and if continued and unabated will lead to serious consequences, and to the damage of this plaintiff."

(3) The defendant has on three different occasions "arbitrarily and unreasonably raised" the re-discount rate which it charges to its member banks.

> "for the purpose and with the effect of raising interest rates generally and call money rates on the New York Stock Exchange in particular."

Through this action interest rates have become unreasonable and plaintiff has been damaged by being obliged to pay such rates for borrowed money and by having the value of his securities depreciated through the sale of securities by persons unwilling or unable to pay these rates.

> (4) "the defendant has wrongfully controlled and seeks to further control the action of member banks in dealing with their own resources by coercing them to call collateral loans made to their customers by said banks on account of their own resources and not re-discounted with defendant or any other Federal Reserve Bank. On various occasions the said Federal Reserve Bank, ... has denied re-discount facilities to certain member banks pending a liquidation of certain other collateral loans and thus occasioned liquidation of securities and reduction of prices due to inability on the part of borrowers to re-negotiate their loans."

The bill finally alleges that by the defendant's acts plaintiff's securities have depreciated and he has been damaged in more than the sum of $3,000.; that the defendant seeks further to control its member banks in the matter of collateral loans and threatens further to raise the re-discount rate.

Frank G. Raichle, Solicitor for Appellant in person; Frank G. Raichle, Robert L. Owen, Carlos C. Alden and Ethan W. Judd, Counsel.

Newton D. Baker and Walter S. Logan, Solicitors and Counsel for Appellee.

AUGUSTUS N. HAND, Circuit Judge:

The wrongs charged against the bank are (a) spreading propaganda concerning an alleged money shortage and increasing volume of collateral loans,

(b) setting about to restrict the supply of credit available for investment purposes by engaging in open market transactions through the sale of its securities, (c) raising the rediscount rate for its member banks in order to reduce the volume of security loans (d) coercing member banks to call collateral loans by declining to rediscount eligible commercial paper for such member banks.

Three principal questions must be considered:

(1) Are the foregoing acts, irrespective of the alleged purpose to reduce the volume of brokers' loans, within the power of the Federal Reserve Bank?

(2) If the acts are generally speaking lawful, are they rendered unlawful because the purpose was to reduce the volume of brokers' loans?

(3) Is the Federal Reserve Board a necessary party to the action?

The Federal Reserve Act marked the end of a long struggle and was thought to afford the solution of many difficulties. When the Independent Treasury Bill was passed in 1846, the effect was completely to divorce the government from all connection with the money market by making it its own banker and by keeping government funds in the vaults of independent treasury office banks. The public then had to depend on state banks for currency and credit, with a result that in times of financial stress is well known.

To meet the necessities of the Civil War, National Banks were established. They became the official depositaries of the government and furnished an enlarged currency because of their ability to issue circulating notes against government bonds deposited with the Treasurer of the United States. They were required to maintain reserves in certain cities based upon a percentage of their deposits. As the government debts of the Civil War became liquidated, the means for issuing currency lessened, though the business requirements of the country were expanding. In such a situation business prosperity inevitably promoted monetary stringency. Moreover, as the reserves were deposited in relatively few banks in the metropolitan centers, when financial stringencies arose, pressure always came on the banks, their deposits would be withdrawn, the rates for call loans would advance and a liquidation of collateral and depreciation of values would ensue.

While the National Banking System was a great improvement over what went before, it provided no central regulating force and furnished no adequate means for controlling interest rates or preventing or lessening financial stringencies and panics. The usual method of furnishing funds needed for business was for the Treasury to deposit moneys from its vaults in the National Banks and to withdraw these deposits if they were used too much in speculation. This was a rather ineffectual way of dealing with complicated and difficult situations. It was dependent too much upon the determination of a single official and lacked the information and guidance that a scientific federal banking system would afford.

To remedy the difficulties we have mentioned, the Federal Reserve Act was passed. The Federal Reserve Banks have national charters and their stockholders are member banks. Each Federal Reserve Bank has nine directors, three chosen from the member banks, three selected as representatives from industry and three designated by the Federal Reserve Board - a central body consisting of the Secretary of the Treasury - the Controller of the Currency and six other members appointed by the President with the consent of the Senate. This Board is given, by law, the power to exercise general supervision over Federal Reserve Banks. It is in terms empowered to examine the affairs of each Federal Reserve Bank and to publish weekly a statement showing the condition of each bank as well as a consolidated statement of all the banks in the system. It is also specifically empowered to permit or, in certain cases, to require Federal Reserve Banks to re-discount the discounted paper of other reserve banks and to suspend, for a limited time, reserve requirements, and it is empowered to review and determine rates of discount to be charged by Federal Reserve Banks "which shall be fixed with a view of accommodating commerce and business."

Furthermore, a Federal Advisory Council is created by the Act with a delegate member from each Federal Reserve Bank. This Council is authorized to confer with the Federal Reserve Board on general business conditions, to make oral or written representations concerning matters within the jurisdiction of the Board and to call for information and to make recommendations in regard to discount rates, re-discount business, note issues, reserve conditions in the various districts, the purchase and sale of gold and securities by reserve banks, open market operations by these banks and the general affairs of the Reserve Banking System.

The foregoing outline shows the broad purposes of the Act and the wide powers of supervision and control given to the Federal Reserve Board over the whole Reserve System. The Congressional Report of Senator Glass stated the objects of the Act as follows:

> "1. Establishment of a more nearly uniform rate of discount throughout the United States, and thereby the furnishing of a certain kind of preventive against overexpansion of credit which should be similar in all parts of the country.
>
> "2. General economy of reserves in order that such reserves might be held ready for use in protecting the banks of any section of the country and for enabling them to go on meeting their obligations instead of suspending payments, as so often in the past.
>
> "3. Furnishing of an elastic currency by the abolition of the existing bond-secured note issue in whole or in part, and the substitution of a freely issued and adequately protected system of bank notes which should be available to all institutions which had the proper class of paper for presentation.
>
> "4. Management and commercial use of the funds of the Government which are now isolated in the Treasury and subtreasuries in large amounts.
>
> "5. General supervision of the banking busi-

ness and furnishing of stringent and careful oversight.

"6. Creation of market for commercial paper."

To carry out the purposes of the Act, Federal Reserve Banks, subject to the supervision of the Federal Reserve Board, are authorized to act as government depositaries and fiscal agents; to receive and maintain the legal reserves of member banks; upon endorsement of member banks to discount notes, drafts and bills of exchange arising out of actual commercial transactions but not "notes, drafts or bills covering merely investments or issued for the purposes of carrying or trading in stocks, bonds or other investment securities, except bonds and notes of the government of the United States"; to make advances to member banks on their promissory notes for not more than fifteen days at rates to be established by the Federal Reserve Banks subject to the review and determination of the Federal Reserve Board provided such promissory notes are secured by eligible paper, or by bonds, or notes of the United States, to receive Federal Reserve notes upon deposit of eligible paper, or gold, or gold certificates, provided a gold reserve of not less than forty per cent of such notes is maintained. (U.S.C.A. Title 12, Ch. 3, Secs. 341-361.)

Federal Reserve Banks may also, under rules and regulations prescribed by the Federal Reserve Board, engage in "Open Market Operations," that is to say, purchase and sell in the open market at home or abroad cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities eligible for rediscount. They may deal in gold coin and bullion at home and abroad; buy and sell, at home and abroad, bonds and notes of the United States and bills, notes, revenue bonds and warrants with a maturity from date of purchase of not exceeding six months, issued by any State, County, district, political subdivision or municipality in the United States, such purchases to be made in accordance with regulations prescribed by the Federal Reserve Board. They may purchase from member banks and sell, bills of exchange arising out of commercial transactions and may "establish from time to time, subject to review and determination by the Federal Reserve Board, rates of discount to be charged by the Federal Reserve Bank for each class of paper, which shall be fixed with a view of accommodating commerce and business." They may establish accounts with other Federal Reserve Banks with the consent and upon the order and direction of the Federal Reserve Board and, under regulations to be prescribed by said Board, may open accounts and establish agencies in foreign countries for the purpose of purchasing, selling and collecting bills of exchange. They may purchase and sell in the open market either from or to domestic banks, firms, corporations or individuals, acceptances of Federal Intermediate Credit Banks and of National Agricultural Credit Corporations whenever the Federal Reserve Board shall declare that the public interest so requires. (U. S. C. A., Title 12, Ch. 3, Secs. 353-357.)

The foregoing provisions enable the Federal Reserve Banks without waiting for applications from their member banks for loans or re-discounts to adjust the general credit situation by purchasing and selling in the open market the class of securities that they are permitted to deal in. The power "to establish from time to time, subject to review and determination by the Federal Reserve Board, rates of discount to be charged by the Federal Reserve Bank" appears in the Act with the open market powers. The two powers are correlative and enable the Federal Reserve Banks to make their rediscount rates effective. The sale of securities does not lessen the total amount of credit available but, by necessitating payment to the Federal Reserve Banks, increases available credit in their hands "with a view of accommodating commerce and business" as provided by the Act. (U.S.C.A. Title 12, Ch. 3, Sec. 357.)

Such being an outline of the powers of the Federal Reserve Board, the Federal Advisory Council and the Federal Reserve Bank, it is necessary to consider whether any of the acts which the bill says were performed by the Federal Reserve Bank of New York were in themselves, irrespective of a purpose to reduce the volume of brokers' loans, unlawful.

Certainly it was lawful to engage in open market transactions by the sale of securities, to fix the rediscount rate and to decline to re-discount eligible paper. Purchases and sales in the open market are specifically authorized by the Act. (U. S. C. A. Title 12, Ch. 3, Secs. 353-356.) Likewise the Act in terms empowers "every Federal Reserve Bank ... to establish from time to time subject to review and determination of the Federal Reserve Board rates of discount to be charged by the Federal Reserve Bank for each class of paper, which shall be fixed with a view of accommodating commerce and business." While it is alleged in the bill that the re-discount rate "has been arbitrarily and unreasonably raised," it was for the defendant, subject to the supervision of the Federal Reserve Board, to determine what would be a reasonable rediscount. It is not contended that the provision for fixing rates of discount is unconstitutional, nor would it seem even reasonable to argue that it is after such decisions as First National Bank v. Union Trust Co., 244 U. S. 416 and Westfall v. United States, 274 U. S. 256, as well as The Legal Tender Case, 110 U. S. 421; Farmers' & Mechanics National Bank v. Deering, 91 U. S. 29, and McCulloch v. Maryland, 4 Wheat, 316.

The Act being constitutional, we are asked to hold that the bank may not sell its own securities and fix the rates at which it will discount or rediscount paper when it is given the power by the specific terms of the Federal Reserve Act to do all of these things. It is important to note that it is not under any compulsion to re-discount eligible paper for the words of the Act in respect to re-discounting are wholly permissive. The Act provides that:

> "Any Federal reserve bank may, subject to regulations and limitations to be prescribed by the Federal Reserve Board discount notes, drafts and bills of exchanges ..." (U.S.C.A. Title 12, Ch. 3, Sec. 348.)

But it is alleged that the bank and the Federal Reserve System generally have wrongfully "spread propaganda concerning an alleged money shortage and expressed alarm over the increasing volume of collateral loans, whereas no shortage exists other than one of their own making which is technical in its nature and artificial in its essence."

As we have already said, the Act requires the Federal Reserve Board to examine the books and affairs of each Federal Reserve Bank, to require such statements as it may deem necessary and to publish each week a statement showing the condition of each bank and a consolidated statement for all the banks. These statements shall show in detail the assets and liabilities and shall furnish full information regarding the character of the money held as reserve and the amount, nature and maturities of the paper and other investments held. The Federal Advisory Council shall also have power to confer with the Federal Reserve Board on general business conditions, make oral or written representations concerning matters within the jurisdiction of the Board and call for information and make recommendations as to discount rates, re-discount business, reserve conditions, the purchase and sale of gold or securities by reserve banks, open market operations and the general affairs of the Reserve Banking System.

In view of such provisions for detailed reports on the condition of the banks and for intercommunication between the Board and the Council regarding the general affairs of the Reserve Banking System, we think it most unlikely that statements as to the condition of affairs cannot be made public by the Board, the Council and the banks. The provisions for reports, representations and recommendations seem to imply <u>public information</u> and when the situation warrants it, public warning. What particular conditions may warrant is necessarily left to those clothed with responsibility for acting. Warning before taking action would seem to be a safer practice than sudden and perhaps drastic action without warning. Plaintiff's assertion that the banks have spread <u>false</u> propaganda regarding a money shortage is inaccurate. It apparently is based on the allegation of the bill that "no shortage exists other than one of their own making which is technical in its nature and artificial in its essence." This is an argumentative and obscure allegation of no value in a pleading. If it means that the Federal Reserve Banks exercised their right to sell in the open market and refused to rediscount eligible paper, it should have said so; but if such were the fact the banks would still have been within their rights and the plaintiff would have gained nothing by the allegation. We, therefore, deem the charge of spreading propaganda without legal significance.

But the plaintiff chiefly relies on his charge that the defendant has engaged in "a course of conduct ... which has had for its object and purpose an arbitrary reduction in the volume of collateral or brokers' loans." It is nowhere said that the Bank has acted in bad faith or has aimed to injure the defendant. But it seems to be thought that it may be said that the acts of the Bank were likely to cause damage to the plaintiff, in fact caused such damage, and therefore gave rise to a cause of action unless some legal justification can be shown.

This general theory of liability was suggested by Justice Holmes in an article entitled "Privilege Malice and Intent," published in Vol. VIII of the Harvard Law Review, as long as ago as 1894. At the time, it was regarded as a somewhat startling generalization by a profession which had viewed all liabilities in tort under the categories of forms of action. But while courts have differed as to when justification exists, the above generalization of Justice Holmes reiterated in XVIII Harvard Law Review by Professor Ames has been more and more used as a convenient means of approaching problems in torts.

Aiken v. Wisconsin, 195 U. S. at p. 204. In many cases such as libel and slander and malicious prosecution, a malevolent motive destroys the privilege, while in cases affecting the use of land, the privilege has frequently been held absolute. No hard and fast rule can be laid down as to when the privilege exists. Indeed it was said in Aikens v. Wisconsin, supra, that what will be considered a justification depends upon "principles of policy." See also Green v. Victor Talking Mach. Co., 24 Fed. (2d) 378. The plaintiff has seized upon the opinion of Justice Holmes in American Bank & Trust Co. v. Federal Bank, 256 U. S. 350, to support his contention that a purpose to reduce the volume of brokers' loans destroys the defendant's ordinary right to sell its own securities, fix the rates for extending credit and warn the public against inflation. But there a Federal Reserve Bank was charged with accumulating checks of country banks and presenting them in large quantities in order to compel these banks to become members of the Reserve Bank, or, at least, to open a non-member clearing account with it. In such circumstances Justice Holmes said that the "United States did not intend by ... statute to sanction this sort of warfare." In the case at bar the "principles of policy" point the other way. It would be an unthinkable burden upon any banking system if its open market sales and discount rates were to be subject to judicial review. Indeed, the correction of discount rates by judicial decree seems almost grotesque when we remember that conditions in the money market often change from hour to hour and the disease would ordinarily be over long before a judicial diagnosis could be made.

Nor is the plaintiff aided by his charge that the defendant has wrongfully controlled member banks by coercing them to call collateral loans made to their customers, for the only method of coercion suggested is the refusal to re-discount eligible commercial paper. Such a refusal was not a wrong because no provision of the Act requires the Bank to discount unless so ordered by the Board.

We can see no basis for the contention that it is a tort for a Federal Reserve Bank to sell its securities in the open market, to fix discount rates which are unreasonably high, or to refuse to discount eligible paper, even though its policy may be mistaken and its judgment bad. The remedy sought would make the courts, rather than the Federal Reserve Board, the supervisors of the Federal Reserve System and would involve a cure worse than the malady. The Bank, under the supervision of the Board, must determine whether there is danger of financial stringency and whether the credit available for "commerce and business" is sufficient or insufficient. If it proceeds in good faith through open market operations and control of discount rates to bring about a reduction of brokers' loans, it commits no legal wrong. A reduction of brokers' loans may best accommodate "commerce and business." (U. S. C. A. Title 12, Ch. 3, Sec. 357.)

Defendant's counsel have made a persuasive argument that upon the facts alleged the questions raised are political and not justiciable. We have not discussed it because without it the defendant's position seems to be unassailable.

It is contended that the bill must in any event be dismissed because of the failure to join the members of the Federal Reserve Board as parties. The "defendant and the Federal Reserve System generally" are charged with spreading propaganda. The Federal Reserve System must include the Board. The Board by the Act is given power to exercise general supervision over Federal Reserve Banks. (U. S. C. A., Title 12, Ch. 3, Sec. 248 (j).)

It is specifically empowered to regulate open market transactions, to review and determine rates of discount and to make reports as to conditions in the Federal Reserve System. In such circumstances, the Bank is, as to the matters complained of here, a governmental agency under the direction of the Federal Reserve Board. If the plaintiff prevailed in his contention the Bank would be enjoined from fixing a discount rate which the Board had presumptively directed. Such a situation under familiar principles renders the Federal Reserve Board an indispensable party to the suit. Alcohol Warehouse Corp. v. Canfield, 11 Fed. (2d) 214.

But the plaintiff contends that such cases as Gnerich v. Rutter, 265 U. S. 388, and Webster v. Fall, 266 U. S. 507, differ from the present because the Federal Reserve Banks are independent units and in that respect differ from agents like the Prohibition Director who is created under a regulation of the Department of Internal Revenue and is subject to the orders of the Commissioner. Moreover, the plaintiff calls attention to the fact that in American Bank & Trust Company v. Federal Reserve Bank, 256 U. S. 350, the Supreme Court maintained jurisdiction without suggesting that the Federal Reserve Board was a necessary party although the bill there alleged that the wrongs done by the Bank were done in pursuance of a policy "accepted by the Federal Reserve Board." But in American Bank & Trust Company v. Federal Reserve Bank, supra, the point that the Federal Reserve Board was an indispensable partywas not raised, so that we must regard Gnerich v. Rutter and Webster v. Fall, supra, as controlling. In the last case the argument was made that in other suits brought against subordinate officials without joining the superior, the court had proceeded to determine the merits but Justice Sutherland said that:

> "Questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents."

We have discussed the merits in case our decision should be reviewed and our opinion that the Federal Reserve Board is a necessary party should be thought erroneous.

The decree is modified so as to dismiss the bill because of failure to join the members of the Federal Reserve Board who are indispensable parties and as so modified, is affirmed.