COPY X-6529

March 7, 1930.

Mr. H. G. Leedy, Counsel,
Federal Reserve Bank,
Kansas City, Missouri.

Dear Mr. Leedy:

As I have just wired you, I did not receive your letter of March 5 transmitting the adverse decision of the Supreme Court of Colorado in the case of First National Bank of Denver v. Federal Reserve Bank until today. In view of the fact that your petition for rehearing must be filed on the 13th instant, less than a week from today, I doubt that Mr. Baker would have time to be of much assistance in preparing it, even if his services were needed.

Upon a hasty examination of the opinion, I am inclined to think that the case involves no question of interest to the Federal reserve system as a whole; first, because it arises under the old regulation J and, second, because it apparently turns largely upon a question of actual negligence. I think it could easily be distinguished from any case arising under the new regulations, and I do not believe that the opinion contains anything which would be very harmful on the general question of the rights and liabilities of Federal reserve banks with respect to check collections. However, in view of the fact that they may disagree with this view, I am taking the liberty of transmitting copies of the opinion and of our correspondence to counsel for all of the other Federal reserve banks with a request for an expression of their views on the question whether this case is of importance to the Federal reserve system as a whole.

Counsel for the other Federal reserve banks apparently have not been furnished with copies of your briefs in this case, and I suggest that it would be advisable to send them copies.

As I wired you today, I seriously doubt the advisability of attempting to obtain a review of this decision by the Supreme Court of the United States. It seems to me that a favorable decision by the Supreme Court would not be of any great value, in view of the fact that the case does not arise under the new regulations; whereas an unfavorable decision might provoke further litigation and might result in an opinion announcing broad principles which could be

effectively quoted against the Federal reserve banks in other check collection cases, even when such cases arise under the new regulations. From a system standpoint, therefore, I am inclined to think we would have everything to lose and very little, if anything, to gain by obtaining a review of this decision by the Supreme Court of the United States. From a system standpoint, I think it would be better policy to await an opportunity to get the Supreme Court to pass upon a case arising under the new regulations, in the hope that a decision rendered in such a case would render the doctrine of the old Malloy case entirely obsolete.

This letter is written after a very hasty consideration, however, and if you disagree with the views herein expressed, I should like very much to have an expression of your own views.

With best personal regards, I am

Cordially yours,

Walter Wyatt,
General Counsel.

WW:vdb

C O P Y

X-6529-a

FEDERAL RESERVE BANK
of
KANSAS CITY

H. G. Leedy, Counsel
1503 Federal Reserve Bank Bldg.,
Kansas City, Missouri.

March 5, 1930.

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

My dear Mr. Wyatt:

The Supreme Court of Colorado has just handed down its opinion in the case of First National Bank of Denver vs. Federal Reserve Bank. As you perhaps will recall, this suit was brought by the First National Bank as assignee, for one of its customers, to recover the amount of various checks which the Denver Branch of our bank sent to the Citizens State Bank of Ordway, Colorado, in September, 1921, and for which remittances by draft were received which could not be collected on account of the closing of the drawee bank.

As I reported at one of the conferences of counsel, the trial court sustained a demurrer to the defenses set up in our answer based on Regulation J and our own General Letter, as well as our defense of custom. Upon the trial of the case, the District Judge adhered to his position with reference to these defenses, and we were permitted to introduce no evidence under them.

There has never been any serious question in my mind that the case would be reversed by the Supreme Court of Colorado, and Messrs. Lewis and Grant, attorneys at Denver, who have been associated with me in its handling, have felt even more confident than I of the ultimate result, if that could have been possible. The decision now handed down, which affirms the judgment of the trial court, comes accordingly as a distinct shock and surprise.

I have not attempted to carefully analyze the opinion, as it has just reached me, but from such examination as I have made of it, it seems that the Court has devoted itself largely to matters which are not at all decisive of the issues, and has failed to recognize the principles and authorities on which we relied. It seems doubtful that the decision, if it stands, will be of any embarrassment either to our bank or other Federal Reserve Banks, inasmuch as at the time the checks were handled there were no express provisions in Regulation J or our General Letter authorizing the acceptance of exchange drafts as remittances. The Court, however, intimates that our General Letter,

even if it had contained specific reference to the acceptance of exchange drafts, is invalid. It is primarily by reason of this reference, and the fact that the Court has apparently refused to give effect to Regulation J, insofar as it permits items to be sent direct, that I am hastening to refer the matter to you.

In order that you may be fully advised in the premises, I am sending you the following:

1. Copy of the opinion of the Supreme Court of Colorado, to which is attached copy of letter of Messrs. Lewis and Grant, transmitting the same to me.
2. Abstract of the Record and Assignments of Error.
3. Brief of Plaintiff in Error.
4. Brief of Defendant in Error.
5. Reply of Brief of Plaintiff in Error.

As pointed out in the letter of Messrs. Lewis and Grant the petition for re-hearing must be filed within ten days from the day the opinion was handed down, which was March 3.

If upon examination of the enclosed, you feel that the decision may have an injurious effect on the reserve banks in their transit operations, and that it would be advisable for Mr. Baker to participate in the preparation of the petition for re-hearing, or to otherwise take part in the further handling of the case, it will be agreeable for you to refer the matter to him; or if you feel that any other course should be followed, I should like for you to suggest the same.

In the meantime, I shall of course collaborate with Messrs. Lewis and Grant in the preparation of a tentative petition for re-hearing, with the view of eventually attempting to obtain a review by the Supreme Court of the United States, should the re-hearing not be granted.

When you have arrived at a decision about the matter, I should be glad for you to advise me thereof by wire.

Yours very truly,

(S) H. G. Leedy.

HGL:FH

C O P Y

X-6529-b

LEWIS AND GRANT
Attorneys and Counsellors at Law
First National Bank Building
Denver, Colorado

Mason A. Lewis
James B. Grant
Robert L. Stearns
F. W. Sanborn, Jr.

March 4, 1930.

H. G. Leedy, Esq.,
Federal Reserve Bank Building,
Kansas City, Missouri.

Dear Mr. Leedy:-

Re: Federal Reserve Bank vs. First National Bank.

Herewith we hand you copy of the "bad news" which we received from the Supreme Court in the above cause late yesterday afternoon. I will not attempt to give you my ideas of the opinion in detail, as I am hurrying to get this copy of the opinion off by special delivery at the earliest possible moment. We only have fifteen days for petition for rehearing, and the same must be printed and filed with the Supreme Court within that time.

In general, I feel that the Court has made some rather bad misstatements of fact and that its conclusions of law are terrible.

If you agree with me that a petition for rehearing should be filed, I would appreciate it if you will formulate your views in support of such petition and let me have them at the earliest possible time.

It is, of course, probable that petition for rehearing will be denied, and in that event I would appreciate knowing your views as to the desirability of attempting to take the case to the Supreme Court of the United States.

With best personal regards.

Very truly yours,

/s/ Lewis and Grant

C O P Y

X-6529-c

No. 12143.

FEDERAL RESERVE BANK OF KANSAS CITY, MISSOURI, a Corporation,

Plaintiff in Error,

vs.

THE FIRST NATIONAL BANK OF DENVER, a Corporation

Defendant in Error.

EN BANC.

Error to the District Court of the City and County of Denver.

Hon. Henry Bray, Judge.

JUDGMENT AFFIRMED.

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MESSRS. LEWIS AND GRANT,
MR. H. G. LEEDY.

Attorneys for Plaintiff in Error.

MESSRS. HUGHES AND DORSEY,
MESSRS. BENEDICT AND PHELPS.

Attorneys for Defendant in Error.

Mr. Justice Burke Delivered the opinion of the Court.

For convenience plaintiff in error is hereinafter referred to as "defendant"; defendant in error as "plaintiff"; The Citizens State Bank of Ordway, Colorado, as "the Ordway State Bank"; the Receiver of said Citizens State Bank of Ordway as "the receiver"; The First National Bank of Ordway, Colorado, as "the Ordway National Bank"; The Central Savings Bank and Trust Company of Denver, Colorado, as "the Trust Company"; the State Bank Commissioner of Colorado as "the commissioner"; John Amicon Brother and Company of Ordway, Colorado, as "the Amicon Co."; The Hallack and Howard Lumber Company of Denver, Colorado, as "the Lumber Co."; and Federal Reserve District No. 10 as "Dist. No. 10."

Plaintiff sent certain checks to defendant for collection which was not made. Alleging that this business was improperly handled to its damage in the sum of $8851.46 it brought this action to recover that amount with interest. The cause was tried to the Court which found for plaintiff in the sum of $7,528.40. To review the judgment entered accordingly defendant prosecutes this writ.

Defendant is organized under the Act of Congress creating Federal Reserve Banks. Plaintiff and the Ordway National Bank are both National Banks, citizens of Colorado, and members of defendant.

The Amicon Co. had a checking account in the Ordway State Bank with a balance therein to its credit of over $8,000. It drew thereon to the Lumber Co. nine checks for various sums, totaling its balance. September 27, 1921, the Lumber Co. indorsed these checks and deposited them with plaintiff for collection. The deposit slip used for that purpose contained the following conditions:

> "This Bank will observe due diligence in its endeavor to select responsible agents, but will not be liable in case of their failure or negligence or for loss of items in the mail. Checks on this Bank will be credited conditionally; if not found good at the close of business on day deposited they will be charged back to the depositor and the latter notified. All items are credited subject to final cash payment and are handled at the risk of depositor."

Plaintiff credited them to the checking account of the Lumber Co. and sent them to defendant for collection. Defendant thereupon indorsed them and sent them for payment to the Ordway State Bank on which they were drawn. Said bank received them on September 29, and on October 5, 1921, issued in payment thereof its draft on the Trust Company, stamped the checks "Paid", returned them to the Amicon Co. and charged that company's account with their face. Said draft on the Trust Company was sent by mail to defendant and received by it October 6, presented to the Trust Company for payment, and by it dishonored. October 8, the Ordway State Bank was closed by the commissioner. Three weeks later defendant notified plaintiff of this failure of the collection. Plaintiff thereupon notified the Lumber Co. and charged the paper back to it. The checks, however, remained in possession of the Amicon Co. All interest of the Lumber Co. has been assigned to plaintiff. Defendant thereafter filed, with the commissioner, its claim, based upon the dishonored draft above mentioned, and has received dividends thereon.

The negligence specifically charged to defendant, and whereon it is alleged its liability rests, consists in ; 1- forwarding said checks direct to the bank on which they were drawn, instead of collecting them through a third party; 2-surrendering said checks for the draft of the Ordway State Bank instead of demanding payment in cash; 3- failing

to collect within a reasonable time or notify plaintiff of that failure. A demurrer to the complaint for want of facts was overruled.

Aside from essential denials in the answer the second defense pleaded a banking custom to remit collections by draft instead of cash; also the provisions of "General Letter No. 233" of defendant (issued under authority of an Act of Congress) and regulation J, series of 1920, of the Federal Reserve Board; all which it is alleged, were a part of its contract with plaintiff and justified its conduct. A third defense asserted that plaintiff was not the real party in interest, because, not being the owner of the Amicon Co. checks it had lost nothing by reason of their cancellation uncollected. This was the contention upon which the demurrer to the complaint was based. A demurrer for want of facts was sustained to said second and third defenses.

The cause was tried to the Court without a jury. Findings were for plaintiff, and to review the judgment thereupon entered defendant prosecutes this writ.

Plaintiff first brought suit in the U. S. District Court for Colorado. The history of it there will be found in First Natl. Bank v. Federal Reserve Bank, 283 Fed. 700, and in 6 Fed. (2nd) 339. Meanwhile, by a U. S. Statute and its construction, (Federal Land Bank v. U. S. Natl. Bank, 13 Fed.--2nd--36) the U. S. District Court lost jurisdiction, and dismissed the cause without prejudice. Plaintiff thereupon filed the present action.

For the purpose of further consideration of this cause we will treat the second defense as standing and, in so far as material, admitted.

In sustaining the demurrer to the complaint in the U. S. Dis-

trict Court for Colorado, on August 16, 1922, Judge Symes did so on the ground that the Lumber Co. and defendant "are entire strangers, and the former, according to the rule in the Federal Courts and the courts of Colorado, has no right of action against the defendant. ***** The Assignor having no right of action, its assignee can be in no better position."

First Natl. Bank v. Fed. Reserve Bank 283 Fed. 700.

February 18, 1924, a cause reached final judgment which involved the liability of the Federal Reserve Bank of Richmond, Virginia, on a check drawn in North Carolina, on a bank in that state, first deposited for collection with a bank in Florida, and passing thence through two others to said Richmond bank which sent it for collection to the drawee, where it was paid with paper thereafter dishonored. In that cause the Supreme Court of the United States held that the rule announced by Judge Symes, supra, was the rule in the Federal courts, but that it "may, of course, be varied by contract, express or implied," and that a Florida statute, adopting the contrary rule, was written into the contract and controlled "the relations of the drawee to the initial bank of deposit."

Federal Reserve Bank v. Malloy 264 U. S. 160.

Assuming that "the Richmond bank was not negligent in sending the check directly to the bank on which it was drawn" the Court therein further held that if a bank receiving commercial paper for collection, "accepts the check of the party bound to make payment and surrenders the paper, it is responsible to the owner for the resulting loss. (Citing cases). It is unnecessary to cite other decisions since they are all practically uniform." The Court then considers the defenses of custom,

and the regulation of the Federal Reserve Board relied upon in the instant case, and so disposes of both as to make them entirely untenable here. The language of Mr. Justice Sutherland, author of that opinion, can not be improved upon, and its repetition would be superfluous. Citation is sufficient.

Thereafter, and on May 25, 1925, this controversy, as framed in the federal forum, reached the Circuit Court of Appeals of the Eight Circuit which held that the contract between the Lumber Co. and plaintiff, as disclosed by the deposit slip, had the same effect as given by the U. S. Supreme Court to the Florida statute in the Malloy case, supra, and that no want of knowledge of the terms of that contract could avail this defendant because "its duties in the premises were exactly the same whether it was acting as agent of the plaintiff or of the Lumber Co. and it can make no difference to defendant whether it is called upon to answer for its neglect of duty" to one of the other.

First Natl. Bank v. Fed. Reserve Bank 6 Fed. (2nd) 339.

Twelve days before that opinion was handed down the Act of Congress depriving the Federal Courts of jurisdiction and later resulting in the dismissal of the cause therein, had become effective, hence, strictly speaking, the judgment is not authority, but we approve its reasoning and conclusions.

Defendant here says all this is answered by City of Douglas v. Federal Reserve Bank 271 U. S. 489; 70 L. Ed. 1051, wherein the Court said:

> "When paper is indorsed without restriction by a depositor, and is at once passed to his credit by the bank to which he

> delivers it, he becomes the creditor of the bank; the bank becomes the owner of the paper, and in making the collection is not the agent for the depositor."

Standing without qualification that language would reverse the Malloy case, which, however, is cited in the opinion and clearly approved. The statement is, of course, intended to apply only in the absence of special contract. The Court thereupon takes up the contention of special contract, which therein rests only upon the following words contained in the pass book: "all out of town items credited subject to final payment," and holds that those words "did not vary the legal rights and liabilities incident to that relationship (of indorser and indorsee) unless it dispensed with notice of dishonor to the depositor." Hence we think this authority inapplicable.

That all this is entirely consistent with our own declaration on the subject, so far as this Court has spoken, seems clear.

> "Whether such a transaction constitutes a sale of the check to the first bank or is merely a deposit for collection depends upon the facts and circumstances attending the transaction."

First Natl. Bank v. Fleming State Bank 74 Colo. 309; 221 Pac. 891.

"Applying these principles to the instant case, we must necessarily hold that the intention of the parties is controlling."

Bromfield v. Cochran et al. _____ Colo. _____;
283 Pac. 45.

We conclude, therefore, that the demurrer to the complaint was properly overruled and that to the third defense properly sustained.

Of the defenses to the charge of negligence it remains only to notice further those of custom and "General Letter No. 233", although both, we think, are answered by the authorities cited. Since the letter

does not provide for collection save in cash it is, if otherwise valid, immaterial here. Assuming the custom it is no defense to negligence.

> Pinkney v. Kanawha Valley Bank 68 W. Va. 254; 69 S. E. 1012; 32 L. R. A. (N. S.) 987.

It is also therein held that if the collecting Bank has reason to doubt the stability of the drawee its diligence should be commensurate with that information; that the general rule is that direct transmission to the drawee is negligence; that if thereby the check, unpaid, is lost to the customer, he has an action in assumpsit against the collector for the full amount thereof.

We think, under the circumstances here disclosed, each of the acts charged, i. e., forwarding direct to the bank on which the checks were drawn, accepting payment in its draft instead of cash, and nine days' delay in action, constituted negligence. That conclusion is strengthened when we consider the three, as we should, collectively. But when we add to these that the Ordway State Bank belonged to a class among which there was at this time known weakness; that the items were, for it, large; that defendant had a member bank in the same small town to which the collection might have been sent; and that the letter of transmittal contained, among others, the following instructions --

> "Do not hold any items, but protest all items over $10 not promptly honored as drawn and return immediately. * * * Wire non-payment of items $500 or over" ---

all of which were violated; and there seems to us no remaining doubt of defendant's negligence and liability. Both, we think, were acknowledged when defendant filed with the commissioner its claim based upon the dishonored draft.

The judgment is affirmed.

Campbell J., not participating