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Banks and Banking-Trusts-Special Deposits

BANKS AND BANKING—TRUSTS—SPECIAL DEPOSITS.—A trust company established a segregate savings investment department which was to receive deposits, invest them in loans and high grade securities, keep these loans and securities separate from other assets of the company, treat them as a special fund which was at all times to equal the total amount of investment deposits outstanding, and pay 5½% interest on the funds received, any withdrawals to be paid only out of the special fund and to be subject to statutory notice restrictions on time deposits enforceable at the option of the bank. For a period of 17 months after the inception of the plan the bank received monies from the savings investment depositors but did not in any manner identify them, comingling them with its general funds. Nor did published statements of resources and liabilities made by the bank during this period indicate that any particular securities had been segregated for the particular benefit of the savings depositors. During the period, however, the officers of the trust company selected certain mortgage notes owned by the bank and placed on each a band bearing the legend "Savings Investment Mortgages," and marked on the ledger sheets of the depositary after each mortgage note so marked the letter "S", but no assignment or endorsement in any form was made upon the notes so banded. The trust company failed and the depositors into the fund sought to impress a trust upon the assets so set aside. Held, that the deposits were special deposits made for a specific purpose, creating a trust in favor of such depositors, entitling them to a preferred claim as to the securities so segregated.[1]

A trust under the classified definition meant, among other things, that the trustee had legal title,[2] was strictly accountable to a court for his management of the fund,[3] and was bound to keep the res separate and distinct from any

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[10] Davis v. Berry (1914), 216 Fed. 413.

[11] International Shoe Co. v. Federal Trade Commission (1930), 280 U. S. 291.

[12] Mooney v. Holohan (1935), 294 U. S. 103, 112, 55 Sup. Ct. Rep. 340.

[13] United States v. Angell (1881), 11 Fed. 34, 43.

[14] Gaines v. Washington (1928), 277 U. S. 81, Frank v. Mangum (1915), 237 U. S. 309, 35 Sup. Ct. 582.

[15] Powell v. Alabama (1932), 287 U. S. 45, 53 Sup. Ct. 55.

[16] Moore v. Dempsey (1923), 261 U. S. 86, 91, 43 Sup. Ct. 265; Frank v. Mangum (1915), 237 U. S. 309, 35 Sup. Ct. 582.

[1] Singlinger v. Dept. Financial Institutions (1936), 199 N. E. 715.

[2] Am. Law Inst. Restatement of Trusts, sec. 2.

[3] Am. Law Inst. Restatement of Trusts, secs. 164, 165, and 187.

other funds at his command,[4] while the cestui had equitable title,[5] was entitled to all benefits accruing from the fund,[6] and, with the exception of the case of breach of trust by the trustee, bore all losses suffered by the res.[7] But the term trust is today often used to describe a relation quite unlike that existing between a trustee and a cestui under a strict trust. This is a consequence of a tendency on the part of the courts to use the trust as a device to reach what is considered an equitable result in a particular case, whether the facts of that case contain all the necessary elements of a strict trust or not. Resulting trusts and constructive trusts have long been cases in point and the practice of using the trust as an equitable device to obtain a desired end has been widely adopted in this country in cases involving special deposits in banks. These decisions are generally based upon a finding that a fiduciary relation was intended by the parties. Needless to say, the courts have often been hard-pressed to reconcile the results reached in these cases with the characteristics generally attributed to the strict trust and they have often been criticized for using the trust device as a means of explaining results reached in cases in which the facts did not satisfy the requirements of a trust, if the term is construed in its literal sense.

Deposits are presumed by the courts, in recognition of general banking practice, to be general,[8] but they will find that a fiduciary relation exists, entitling the depositor to a preference over the general creditors, if upon an examination of the facts it is found that an agency,[9] bailment,[10] or trust[11] relation was actually intended by the parties. The ordinary special deposit, where the depositary is, by the terms of the agreement, to keep the funds separate, presents little difficulty, as in these cases the court can justifiably find that a bailment or agency relation was created. However, when the agreement provides for no segregation of the original funds, but merely states the purpose for which the funds are to be used, the courts experience difficulty in justifying a finding that one of the above relationships was intended, as a more detailed examination of these theories reveals.

One method which has been used by the courts in such cases is to find that an agency relation was intended.[12] But can an agency relation be said to exist when a bank accepts the funds, commingles them with its own, and uses the commingled deposit for its own benefit and profit? Strict agency law does not permit the agent to profit from the use of funds of his principal.[13] Fur-

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[4] Am. Law Inst. Restatement of Trusts, sec. 179.

[5] Am. Law Inst. Restatement of Trusts, sec. 2.

[6] Subject, of course, to the terms of the creating instrument. Am. Law Inst. Restatement of Trusts, sec. 128.

[7] Am. Law Inst. Restatement of Trusts, secs. 204, 205.

[8] Hjelle v. Veigel (1926), 169 Minn. 173, 210 N. W 891, Busher v. Fulton (1934), 128 Ohio St. 485, 191 N. E. 752; 1 Morse, Banks and Banking (6th ed. 1928), sec. 186.

[9] Duncan v. Anderson (1926), 120 Okla. 194, 250 Pac. 1018; Pacific Bldg. & Loan v. Central Bank & Trust Co. (1923), 127 Wash. 524, 221 Pac. 313.

[10] Montague v. Pacific Bank (1897), 81 Fed. 602; Stultz v. Gordon (1929), 89 Ind. App. 611, 167 N. E. 564.

[11] Titlow v. Sundquist (1916), 234 Fed. 613; Blummer v. Scandinavian Am. State Bank (1926), 169 Minn. 89, 210 N. W. 865. For a more detailed analysis of the use of these three devices see 8 So. Cal. L. R. 122.

[12] An agent can hold legal title to property for his principal. Agency Restatement, sec. 423.

[13] Agency Restatement, sec. 13.

ther, granting that such a fiduciary relation exists, the question arises: should a principal who allows an agent to commingle his funds be permitted to claim a preference in event of the insolvency of that agent?

The objection to the use of the theory of bailment in these cases is that ordinarily title has passed to the bank and that the parties did not intend the return of the original subject matter, strict bailment law requiring that title stay in the bailor and, as a rule, demanding that the original subject matter be returned. Under the fungible goods doctrine, however, there may be a bailment of grain where the original subject matter was not to be returned, but only grain of a like kind and quality.[14] This doctrine has been applied to cases involving the return of corporate shares,[15] liberty bonds where only the same kind and issue were to be returned,[16] and some cases intimate that it might be applied to deposits of money.[17]

The trust device is probably more used than either of the above to establish preferred claims in favor of depositors for a specific purpose who have not provided that their funds be segregated. A trust relationship has been found where such deposits were made to meet some particular expenditures,[18] for security,[19] for remittance,[20] or to be paid over on the happening of a certain event.[21] Such cases seem to be the weight of authority in this country, although there is a minority view which follows the English rule,[22] denying the existence of such a fiduciary relationship when there has been no actual segregation.[23] These latter cases would seem to be more logical in result, as they take cognizance of the objection most often raised to the use of a trust in such situations, namely, that there is no definitely ascertainable res upon which to erect a trust, unless the obligation of the bank to the depositor be regarded as a chose in action constituting a sufficient res. Further, there appears to be no reason why mere evidence of the use to which such funds are to be put should be sufficient to create a specific deposit, for it is entirely consistent with the debtor-creditor relationship that the creditor instruct the debtor for what the money is to be used.

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[14] Rice v. Nixon (1884), 97 Ind. 97, Barrows v. Wampler (1899), 24 Ind. App. 578, 57 N. E. 262. See note 54 A. L. R. 1166.

[15] Fosdick v. Green (1875), 27 Ohio St. 484; Taussig v. Hart (1874), 58 N. Y. 425.

[16] Stultz v. Gordon (1929), 89 Ind. App. 611, 167 N. E. 564. Noted 5 Ind. Law Journal 216.

[17] Bank of America Nat. Trust & Sav. Assn. v. Cal. Sav. & Comml. Bank (1933), 218 Cal. 261, 22 Pac. (2nd.) 704, 709; Flach v. Hood (1933), 204 N. C. 337, 168 S. E. 520, 522.

[18] Craig v. Bank of Granby (1922), 210 Mo. App. 334, 238 S. W. 507; Hitt Fireworks Co. v. Scandinavian-Am. Bank (1922), 121 Wash. 261, 209 Pac. 680.

[19] Woodhouse v. Crandall (1902), 197 Ill. 104, 64 N. E. 292; Flint Road Cart Co. v. Stephens (1888), 32 Mo. App. 341.

[20] State v. Grills (1912), 35 R. I. 70, 55 Atl. 281; Cutler v. Am. Exch. Bank (1889), 113 N. Y. 593, 21 N. E. 710.

[21] Shopert v. Ind. Natl. Bank (1908), 41 App. 474, 83 N. E. 515, Stein v. Kemp (1916), 132 Minn. 44, 155 N. W 1052.

[22] In Re Barned's Banking Co. (1870), 39 L. J. (Ch.) 635, limiting Farley v. Turner (1857), 26 L. J. (Ch.) 710.

[23] First Nat. Bank v. City of Miami (1934), 69 Fed. (2nd.) 346; Borgess Hosp. v. Union Industrial Trust & Savings Bank (1933), 265 Mich. 156, 251 N. W 363, Beecher v. Cosmopolitan Trust Co. (1921), 239 Mass. 48, 131 N. E. 338.

It was found in the instant case, upon construing the language of the contract, that the parties intended a trust relationship to exist, the decision being based upon the rules set forth in the pass book to the effect (1) that the deposits were to be invested in approved securities which were to be kept separate from all other assets of the company and treated as a special fund, (2) that the company was to keep in the special fund a total of securities and cash equal to the total savings investments; and (3) that the depositors were to be paid only out of the separate assets of the fund and not out of the other funds of the depositary. The court's decision may well be questioned, however, when it is considered that the contract also provided (1) that 5½% interest was to be paid to the depositors; (2) that all earnings of the fund were to go to the company and not to the depositors; and (3) that withdrawals would be paid on demand, unless the bank saw fit to invoke the statutory notice requirements. While the payment of interest is not conclusive proof of a debtor-creditor relationship, it is one of the strongest indicia that a loan and not a trust was intended.[24] This presumption is strengthened in the instant case by the fact that the bank was to be entitled to the earnings of the fund, which fact is certainly inconsistent with a finding that a fiduciary relationship was intended. Further, it has been held that when a depositor has the right to withdraw from his account for all purposes, as here, such account shall be deemed a general deposit, title thereto passing to the bank.[25] The reservation of the right to invoke the statutory notice requirements on withdrawals would also seem to indicate that a debtor-creditor relationship was intended, as the savings investment depositors were thereby placed in the same class as the ordinary savings depositor in this respect.

When, however, the contract is viewed in the light of the later acts of the parties, the court's finding that it was the intention of the bank that a fiduciary relationship be created becomes even more untenable. From the date of origin of the plan until the bank closed, the company commingled the savings investment deposits with its general funds. This action is consistent only with an understanding by the bank that these deposits were general in character. Further, while the funds were so commingled, and before the notes were banded, it would have been impossible for the depositors, as cestuis, to bear the losses to the savings investment fund, as there was no such fund in existence. Another fact which evidences an understanding by the bank that the deposits were general is that, if at any time while the funds were commingled, sufficient cash had been segregated to establish a fund to repay the savings depositors in full, the bank would have fallen below the statutory requirements as to cash reserves. Thus it would seem that one party to the contract, namely the depositary, at no time considered the depositors to be other than general creditors, despite the court's finding to the contrary. M. E. W

CONSTITUTIONAL LAW—INTERSTATE COMMERCE—PEDDLERS.—The town of Sellersburg passed an ordinance levying a license tax of twenty-five dollars per year on peddlers and hawkers. The defendant was arrested and charged with peddling without having procured a license. The defendant was employed

[24] Cline v. Union Trust Co. (1934), 99 Ind. App. 296, 189 N. E. 643, 647, Mo. etc. v. Holland Banking Co. (1927), 290 S. W 101, 103, Old Colony v. Puritan (1923), 244 Mass. 259, 138 N. E. 321, 323.

[25] In re North Missouri Trust Co. (1931), 39 S. W. (2nd) 412.