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# Banks and Banking-Priority of Public Fund Deposits in Insolvent Banks

BANKS AND BANKING—PRIORITY OF PUBLIC FUND DEPOSITS IN INSOLVENT BANKS.—Wells County Bank qualified as a public depository and therein were deposited state funds derived from sale of automobile license plates. Upon the insolvency of the bank, the state claims a preference to these funds over other creditors. The court held that the state had no preference, the court settling the question as to whether a claim due to the state, by reason of its sovereignty, is entitled to a preference over all other creditors by referring to a case previously decided in Indiana; the state, however, was given preference on grounds not pertinent to the question here discussed.[1]

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141 Atl. 542; Eureka Laundry Co. v. Long (1911), 146 Wis. 205, 131 N. W. 412; Samuels Stores, Inc. v. Abrams (1919), 94 Conn. 248, 108 Atl. 541.

[12] Kinney v. Scarbrough Co. (1912), 138 Ga. 77, 74 S. E. 772; 9 A. L. R. 1473; 1 Page, Contract, sec. 376-379.

[13] Duerling v. City Baking Co. (1928), 155 Md. 280, 141 Atl. 542 (3 months); A. Fink & Sons v. Goldberg (19 ), 101 N. J. Eq. 544, 139 Atl. 408 (1 year—clothing business); Axelson v. Columbine Laundry Co. (1927), 81 Colo. 254, 254 Pac. 990 (6 months).

[14] Oak Cliff Ice Delivery Co. v. Peterson (1927, Tex. Civ. App.), 300 S. W. 107, (3 years—within 5 squares of routes upon which employee had worked); Granger v. Craven (1924), 159 Minn. 296, 199 N. W. 10 (3 years—within a town of 20,000 and 20 miles thereof); Eureka Laundry Co. v. Long (1911), 146 Wis. 205, 131 N. W. 412 (2 years).

[1] State ex rel. Symons, Bank Commissioner v. Wells County Bank et al. (1935), 196 N. E. 873 (Ind.).

There is no dispute as to whether or not the United States Government has priority rights to funds which it had deposited in an insolvent state bank or an insolvent national bank; and there is no dispute as to whether or not the state has priority rights for funds which it had deposited in insolvent national banks. A federal statute provides that whenever any person who is indebted to the United States Government becomes insolvent, all claims due to the Government shall first be satisfied.[2] Under this statute the claims of the United States Government against insolvent state banks take preference.[3] But due to the peculiar wording of the National Banking Act, the Federal Government does not have a preference to federal funds deposited in a national bank.[4] When state funds are deposited in national banks, the state is not entitled to a preference, even though a state statute provides otherwise;[5] but a national bank is authorized to give security for the state deposits, and the state law determines such procedure.[6] However, it is when we consider the preference of the state to funds which it had deposited in a bank other than a national bank, which bank thereafter becomes insolvent, that the great dispute arises. By reason of the decision in the instant case, and the authority to which the court referred, it may be concluded that the State of Indiana does not take a preference over other creditors in the assets of an insolvent state bank in liquidation for funds which it had deposited there.[7] If, however, the deposit were a wrongful one, it will leave open a door through which the courts can establish the doctrine of a constructive trust in favor of the state, and permit the state to take precedence in the distribution of assets.[8] An examination of cases in point in other states will reveal that the question is one in which the courts are not in general accord. Of those courts who hold that the state is entitled to preference, the majority argue that the state adopted the common law as it existed in England insofar as it was not local in nature and applicable to the conditions of the people and not incompatible with our political institutions. As a consequence, the state must have adopted that part of the common law which gave to the British Crown a priority in payment of debts due it from an insolvent debtor, as against other creditors not having a specific lien.[9]

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[2] Rev. Stat., sec. 3466, 2 Fed. Stat. Ann. 45, 31 U. S. C. A. sec. 191.

[3] U. S. v. State Bank of N. C. (1832), 6 Pet. (31 U. S.) 29, 8 L. ed. 308.

[4] Rev. Stat., sec. 5236, 5 Fed. Stat. Ann. 176.

[5] First National Bank v. Selden (1903), 120 Fed. 212, 56 C. C. A. 532 (Ill.); Palto Alto County v. Ulrich (1924), 199 Iowa 1, 201 N. W. 132; Fiman v. State of S. D (1929), 29 Fed. (2nd) 776 (S. D.); Old Companies Lehigh, Inc v. Meeker (1934), 71 Fed (2nd) 280 (N. Y.); Webster v. U. S. Fidelity and Guaranty Co. (1934), 71 Fed. (2nd) 475 (Miss.); Spradlin v. Royal Mfg. Co. (1934), 73 Fed. (2nd) 776 (N. C.).

[6] 12 U. S. C. A., sec. 90; Fidelity and Deposit Co. of Md. v. Kokrda (1933), 66 Fed. (2nd) 641 (Colo ).

[7] Fidelity and Deposit Co. of Md. v. Brucker et al. (1933), 205 Ind. 273, 183 N. E. 668. Cf. Burns (1933) 61-810, which provides that the State Treasurer, to the extent that it shall have paid off the loss of public deposits, shall be entitled to subrogation, "and shall share in the distribution of the assets of such closed depository on such basis ratably with other depositors."

[8] State ex rel. Symons Bank Commissioner v. Wells County Bank et al. (1935), 196 N. E. 873 (Ind.); Bogert, Trusts and Trustees (1935), Vol. 1, sec. 21; Restatement of the Law of Trusts, Tentative Draft No. 1, sec. 15(h).

[9] People ex rel. Nelson v. Marion Trust and Savings Bank (1932), 347 Ill. 445, 179 N. E. 893.

"At common law," said Mr. Justice Brandeis, in Marshall v. N. Y., 254

The courts following the common law rule would say that where statutes do exist, they are simply a codification of the common law rule.[10] A few decisions announce the principle that a bank is the trustee of public funds,[11] but this position is legally difficult to support.[12] It is not contemplated by either the public depositor or the bank that the latter is to keep the money with which to meet public checks segregated from the other deposits of money; in other words, there is no definite *res* to which the trust can attach, and instead of a trust relationship a simple debtor-creditor relationship is established.[13] And if the deposit is made by an officer who is deemed to be trustee of the public funds, there is no reason for changing the above rule.[14] On the other hand are those cases which refuse the state priority in the distribution of the assets of an insolvent bank, the theories behind the result being almost as numerous as the cases themselves.[15] Among the reasons given by the courts are these: (1) No right ever existed at common law which would give the state prefer-

U. S. 380, 65 L. ed. 315, "the Crown of Great Britain, by virtue of a prerogative right, had priority over all subjects for the payment out of a debtor's property of all debts due it. The priority was effective alike whether the property remained in the hands of the debtor, or had been placed in the possession of a third person, or was in *custodia legis*. The priority could be defeated or postponed only through the passing of title to the debtor's property, absolutely or by way of lien, before the sovereign sought to enforce his right."

People v. Farmer's State Bank (1929), 335 Ill. 617, 167 N. E. 804; People v. West Englewood Trust and Savings Bank (1933), 353 Ill. 451, 187 N. E. 525; State Bank of Commerce v. U. S. Fidelity and Guaranty Co. (1930), 28 S. W. (2nd) 184; U. S. Fidelity and Guaranty Co. v. Carnegie Trust Co. (1914), 146 N. Y. S. 804, affd. 213 N. Y. 629, 107 N. E. 1087; State ex rel. Rankin v. Madison State Bank (1923), 68 Mont. 342, 218 Pac. 652; Aetna Accident and Life Co. v. Miller (1918), 54 Mont. 377, 170 Pac. 760; Woodyard v. Sayre (1922), 90 W. Va. 295, 110 S. E. 689; U. S. Fidelity and Guaranty Co. v. Central Trust Co. (1924), 95 W. Va. 458, 121 S. E. 430; Central Trust Co. v. Bank of Mullins (1930), 107 W. Va. 679, 150 S. E. 221; Fidelity etc. Co. v. Rainey (1908), 120 Tenn. 357, 113 S. W. 397; Fidelity and Deposit Co. of Md. v. State Bank of Portland (1926), 117 Ore. 1, 242 Pac. 823; U. S. Fidelity and Guaranty Co. v. Bramwell (1923), 108 Ore. 261, 217 Pac. 332; State v. State Bank (1848), 6 Gill and J. (Md.) 205; State v. Foster (1895), 5 Wyo. 199, 38 Pac. 926; Robinson v. Bank of Darien (1855), 18 Ga. 65; Booth v. State (1909), 131 Ga. 750, 63 S. E. 502; Central Bank & Trust Co. v. State (1912), 139 Ga. 54, 76 S. E. 587; Fogg v. Friar's Point Bank (1902), 80 Miss. 750, 32 S. 285; Metcalfe v. Merchants etc. Bank (1906), 89 Miss. 649, 41 S. 377; U. S. Fidelity etc. Co. v. Shaw First State Bank (1913), 103 Miss. 91, 60 S. 47; In re Marathon Savings Bank (1924), 198 Iowa 696, 196 N. W. 729, 200 N. W. 199; In re So. Phila. State Bank's Insolvency (1929), 295 Pa. 433, 145 Atl. 520; Fimon v. S. D. 1929), 29 Fed. (2nd) 776, 279 U. S. 841.

[10] Iowa Code Supplement (1913), sec. 3825(a); Miss. Code (1906), sec. 3485; S. C. Code (1902), sec. 2538; 17 Marquette L. Rev. (1933) 213. Contra: State v. Harris (1832), 18 S. C. (2 Bailey) 598; also, Campion v. Village of Graceville (1930), 181 Minn. 446, 232 N. W. 917.

[11] State v. Midland State Bank (1897), 52 Nebr. 1, 71 N. W. 1011; Sorenson v. First Natl. Bank (1932), 122 Nebr. 502, 24 N. W. 747; Watts v. Cleveland County (1908), 21 Okla. 231, 95 Pac. 771; Md. Casualty Co. v. McConnel (1924), 148 Tenn. 656, 257 S. W. 410.

[12] (1932) 2 Idaho L. J. 57.

[13] Bogert, Trusts and Trustees (1935), Vol. 1, sec. 21, and cases cited.

[14] Bogert, Trusts and Trustees (1935), Vol. 1, sec. 21, and cases cited.

[15] (1933) 33 Col. L. Rev. 530.

ence.[16] (2) Even though the right did exist at common law, it was inconsistent with the cardinal concepts of free government and would not be adopted by the particular state.[17] This the state, with perfect propriety, had the right to do, since the adoption of the common law in this country was left to the states to determine.[18] (3) The state in depositing public funds was acting in its business or proprietary capacity; it had stepped down into the arena of common business, and by so doing, the state was not entitled to the preference of the sovereign.[19] It has been observed in refutation, however, that since the power to deposit money for safekeeping must be a necessary incident to the collection and disbursement of public funds, the exercise of the power should still be recognized as sovereign.[20] (4) By the enactment of the depository laws and the requirement that the bank furnish security for the state deposits, the rule for giving the state preference fell with the reason,[21] and the state was said to have waived or abrogated its priority right.[22] Although the argument is made that the surety company furnishing the security may itself become insolvent thus necessitating the continuance of the preference,[23] and although it may be argued that the court has no right to disregard the common law rule of preference without a necessary implication or an express waiver by the legislature,[24] it is submitted that the courts reasoning is nevertheless one

[16] Board of County Commissioners v. McFerson (1932), 90 Colo. 408, 9 Pac. (2nd) 614.

[17] Fidelity and Casualty Co. of N. Y. v. Union Savings Bank Co. (1928), 119 Ohio 124, 162 N. E. 420; Commissioner of Banking v. Chelsea Savings Bank (1910), 161 Mich. 691, 125 N. W. 424, 127 N. W. 351; Chosen Freeholders v. State Bank (1878), 29 N. J. Eq. 268, affd. N. J. Eq. 311; N. C. Corp. Comm. v Citizens Bank and Trust Co. (1927), 193 N. C. 513, 137 S. E. 587; Lake Worth etc. v. First American Bank and Trust Co. (1929), 97 Fla. 174, 120 S. 316; Denny v. Thompson (1931), 236 Ky. 714, 33 S. W. (2nd) 670; U. S. Fidelity and Guaranty Co. v. Carter (1933), — Va. —, 170 S. E. 764.

[18] N. C. Corp. Comm. v. Citizens Bank and Trust Co. (1927), 193 N. C. 513, 137 S. E. 587; Wheaton v. Peters, 8 Pet. 591, 659.

[19] National Surety Co. v. Morris (1925), 34 Wyo. 134, 241 Pac. 1063; Fidelity and Casualty Co. of N. Y. v. Union Savings Bank Co. (1928), 119 Ohio 124, 162 N. E. 420; Campion v. Village of Graceville (1930), 181 Minn. 446, 232 N. W. 917; State v. Carlyon (1932), 166 Wash. 498, 7 Pac (2nd) 572. The court here said that "the state is bound by principles of equitable estoppel, and in business relations with individuals must not expect more favorable treatment than is fair between men." Maryland Casualty Co. v. Rainwater, Bank Commissioner (1927), 173 Ark. 103, 291 S. W. 1003.

[20] (1933) 81 Pa. L. Rev. 441.

[21] U. S. Fidelity and Guaranty Co. v. McFerson (1926), 78 Colo. 338, 241 Pac. 728.

[22] National Security Co. v. Morris (1925), 34 Wyo. 134, 241 Pac. 1063; National Surety Co. v. Pixton (1922), 60 Utah 289, 208 Pac. 878; In re Central Bank of Willcox (1922), 23 Ariz. 574, 205 Pac. 915; In re Holland Banking Co. (1926), 313 Mo. 307, 281 S. W. 702; U. S. Fidelity and Guaranty Co. v. McFerson (1926), 78 Colo. 338, 241 Pac. 728; Shaw, Banking Commissioner v. U. S. Fidelity and Guaranty Co. (1932), 48 S. W. (2nd) 974, 977; State v. Carson Valley Bank (1933), 23 Pac. (2nd) 1105; Commonwealth v. Commissioner of Banks (1922), 240 Mass. 244, 133 N. E. 625; Commissioner of Banking v. Chelsea Savings Bank (1910), 161 Mich. 691, 125 N. W. 424, 127 N. W. 351.

[23] Commissioners of San Miguel v. McFerson (1932), 90 Colo. 408, 9 Pac. (2nd) 614.

[24] Booth and Flinn v. Miller (1912), 237 Pa. 297, 85 Atl. 457.

with a great deal of merit, since the primary purpose of priority in the first place is for the safety of the public funds, and since this is achieved through another method equally effective, priority in an insolvent bank's funds is no longer necessary. (5) The right is lost when the title to the property vested in another, as where there was an assignment for the benefit of creditors, or there was a receiver appointed before the state filed its claim.[25] This seems logical enough, in view of the fact that the English Crown, who was entitled to a preference, also lost it when the title was divested from the insolvent debtor and vested in another.[26] (6) When the state passed a statute providing for the marshalling of claims, and nothing was stated in the statutes concerning the state's preference, the state's preferential right was said to be abrogated.[27] (7) Private depositors would be more likely to favor national banks for their personal deposits, because the state, having no priority in the assets of an insolvent national bank, but having priority in the assets of an insolvent state bank, would cause a decrease in the available assets of the state bank on which the private depositor could realize in case of the state bank's insolvency. There would be no such decrease in the assets of an insolvent national bank.[28] Indiana seems to base its decision on the ground that whatever prerogative was given by common law, it was a prerogative given to the King of England, personally, and not one which was possessed by the state government; and furthermore, even if it could be said that the priority was a prerogative existing in favor of the state, the state in making its deposit was not exercising its power as a sovereign, but was acting in a proprietary capacity.[29] In any event, whatever course the courts may pursue in determining whether a state has preference, it is clear that the courts agree that if preference is to be given, it should not extend to the political subdivisions of the state, in the absence of a statute.[30] This survey of the decisions in the states reveals a difference of opinion as to whether a state should be given a preference in the assets of an insolvent bank. Those states which allow the prerogative, base the decision on ideas of public policy[31]—that it is essential to the public welfare of the state that the state's funds be protected, and that the normal governmental functions must not be impeded by abnormal business conditions. Conceding this theory of public policy to be correct, in view of the fact that the states now have depository laws and require the banks to give security for its deposits, it is submitted that public policy has been effected by methods other than granting a preference to the state; in a way which not only protects

[25] Aetna Casualty and Surety Co. v. Moore (1919), 107 Wash. 99, 181 Pac. 40; Public Indemnity Co. v. Page (1931), 161 Md. 239, 156 Atl. 791; State v. First State Bank (1917), 22 N. M. 661, 167 Pac. 3; State v. Peoples Savings Bank and Trust Co. (1918), 23 N. M. 282, 168 Pac. 526.

[26] Marshall v. N. Y. (1920), 254 U. S. 380, 65 L. ed. 315.

[27] Basset v. City Bank and Trust Co. (1932), 115 Conn. 393, 161 Atl. 852.

[28] In re Holland Banking Co. (1926), 317 Mo. 307, 281 S. W. 702.

[29] Fidelity and Deposit Co. of Md. v. Brucker et al. (1933), 205 Ind. 273, 183 N. E. 668.

[30] (1934) 20 Va. L. Rev. 480; (1934) 32 Mich. L. Rev. 692.

[31] (1933) 17 Marq. L. Rev. 213; (1934) 20 Va. L. Rev. 480; (1933) 81 Pa. L. Rev. 441; State ex rel. Rankin v. Madison State Bank (1923), 68 Mont. 342, 218 Pac. 652, where it was stated that giving the state preference "is based upon public policy, in order that the state's funds may not be lost, but may be available to meet governmental expenses and discharge the state's obligations.

the deposits of the state, but prevents an encroachment on the rights of the citizens of the state to have an equal share in the recovery of their own funds which they have deposited in the same bank that the state had deposited its funds. It is not surprising, therefore, that although the reasons given by the states denying a preference are manifold, they all arrive at the same result, and, although admitting the common law prerogative, they will find a method for denying a preference which they regard as unjustified. Although a few years back the instant case may have been considered to be in the minority,[32] so far as the writer is able to ascertain, the instant case is now in accord with the better and majority rule. H. B.

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MUNICIPAL CORPORATIONS—TAXATION—SUPERVISORY CONTROL OF STATE BOARD OF TAX COMMISSIONERS.—Action by the City of Indianapolis to enjoin the Auditor and Treasurer of Marion County from reducing the tax levy of the city as ordered by the State Board of Tax Commissioners upon an appeal to said commission pursuant to the provision of Sec. 200 of c. 95 of the Acts of 1927. (Burns' 1933, Sec. 64-1331.) The complaint alleges that the action of the State Board of Tax Commissioners in making said reduction is illegal and void in that the section of the act in question is unconsitutional, both as to giving the state board authority (1) over municipal activities in regard to those matters affecting the inhabitants in that community, and (2) as authorizing such state board to exercise both legislative and judicial power in matters of taxation. The cause was tried by the Superior Court of Marion County and judgment rendered enjoining the appellees from extending upon the tax duplicates the reduced levies. Held, judgmnt reversed. The General Assembly, in enacting tax laws, has authority to reserve a check upon municipalities levying taxes and assessments and to lodge supervisory control in a state administrative board.[1]

A municipal corporation is a body politic created by the incorporation of the people of a prescribed locality and invested with subordinate powers of legislation to assist in the civil government of the state and to regulate and administer local and internal affairs of the community.[2] The courts have generally regarded a municipal corporation as a subordinate branch of the government of the state and as an instrumentality of state administration for conducting the affairs of the government.[3] In legal theory the municipal corporation is strictly public in character, the creature of the legislative power of the state, whether that power is exercised directly, or by the state legislature. From the principle that the legislative power of the state is the sole source of its corporate life, follows the generally accepted rule that a municipal

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[32] (1933) 19 Va. L. Rev. 868; (1933) 17 Marq. L. Rev. 213.

[1] Dunn v. City of Indianapolis (1935), 196 N. E. 528.

[2] 1 McQuillin, Municipal Corporations (1928, 2nd ed.), p. 369; 1 Dillon, Municipal Corporations (1911, 5th ed.), p. 58; Schneck v. City of Jeffersonville (1898), 152 Ind. 204, 52 N. E. 215.

[3] State v. Gullatt (1923), 210 Ala. 452, 98 So. 373, 376; Valley Rys. v. Harrisburgh (1924), 280 Pa. 385, 124 Atl. 644, 648; Ottawa v. Carey (1883), 108 U. S. 110; Williams v. Eggleston (1898), 170 U. S. 304, 310; Trenton v. New Jersey (1923), 262 U. S. 182, 43 Sup. Ct. 534, 67 L. ed. 937.