Banker's Liens on Deposits Subsequent to Indebtedness

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factors, it seems to rest, so far as this aspect of the case is concerned, upon the tacit assumption that a mere judgment creditor is not in a position to invoke marshaling of assets. So long as the process is to be confined to the relative privileges of specific lienholders, the result seems sound.

J. W. Crew, Jr.

Banker's Liens on Deposits Subsequent to Indebtedness

The question arises in a recent Virginia case as to a bank's right to set off a depositor's indebtedness to it against his balance on simple account when the money deposited was of a fiduciary character, the bank having no notice or knowledge of this fact, and when the debt had been created before this deposit. These funds were the proceeds of a note collected by the depositor for the plaintiff, another bank, which now seeks to show its equities and defeat the set-off. Held: Plaintiff bank cannot recover.

There is an absence of decision on this question in North Carolina. The cases in other states are in conflict, the weight of authority, however, being in accord with the principal case.

Where the depositary has knowledge that the money deposited belonged to a third person, or where the circumstances are such as to compel an inquiry as to the relation between the depositor and the funds deposited, no set-off is allowed, on the equitable principle that one who knows or should know that certain property belongs to another cannot deal with it in such manner as to interfere with or extinguish the other's rights thereto. Where, however, the depositary has extended credit or has in any other way changed its position to its detriment in reliance upon the credit of the funds deposited without notice of another's interest therein it is conceded that the bank may retain as against the beneficial owner. This conclusion is reached in some jurisdictions on the general grounds that where

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1 Federal Reserve Bank v. State and City Bank, 143 S. E. 697 (Va., 1928).
one of two innocent persons must suffer, the loss should fall upon the one who permitted the depositor to deal with the funds as his own. In others it is held that the depositary becomes the holder in due course for a valuable consideration.4

The character of the indebtedness against which the deposit balance is set off, has often been an influencing factor. Where it is an overdraft, it is argued that it was in reliance upon the future deposits in the general course of the business that the overdraft was allowed to occur, and was intended to be liquidated as soon as sufficient funds came into the hands of the bank.

It has been held that an express agreement with the bank that it may apply deposits to the indebtedness gave the bank rights beyond those flowing from the ordinary relation, and outside of the banker's lien.5 And the fact that the depositor has consented to the application of the funds to a particular debt has been held to be an important factor, although to what extent it influenced the decision the courts do not say. In McStay Supply Co. v. Stoddard6 the court declared, "The bank has a lien upon all funds belonging to depositor, deposited [italics ours] for any indebtedness owing to it by the depositor." This statement brings up the question of whether or not the deposit was made specifically to secure that indebtedness.7 Cases containing such distinguishing features as differences in type of indebtedness, special agreements for security, consent to application, etc., have been cited as authority for one another with a resulting confusion which makes predictability difficult.

But it is in the absence of these factors that most dissension occurs, and it is to such a case that the following discussion refers.

Various theories are advanced for the result reached in the instant case. The one most generally accepted, however, is: That the relation between depositor and depositary is that of creditor and debtor, the bank receiving full title to the funds deposited while the depositor becomes merely a creditor of the bank for an equivalent amount of money, and that a bank has a lien or right of set-off of any debt due it by the depositor, against funds deposited.8

4 See Note 9.
5 Hatch v. Fourth Nat. Bank, 147 N. Y. 184, 41 N. E. 403 (1895). The inference is that upon the strength of the banker's lien alone the set-off may not have been allowed.
6 McStay Supply Co. v. Stoddard, 35 Nev. 284, 132 Pac. 545 (1913).
7 Smith v. Des Moines Bank, 107 Iowa 624, 78 N. W. 238 (1899).
Another line of decisions rests upon the elementary proposition that if a trustee uses trust money to pay an antecedent debt to a creditor who has no notice that the money is subject to trust, the money becomes free from the trust.\(^9\) In some jurisdictions, however, an antecedent debt was not, prior to the N. I. L., valuable consideration. Section 25\(^9\) of the N. I. L. has cured this difficulty. But it may fairly be argued that a bank's off-set of a deposit which a fiduciary depositor never intended to be applied to his individual indebtedness is on a different footing from a voluntary payment by the trustee. To hold otherwise would seem tantamount to making a trustee guilty of a breach of trust when there was no such intention on his part and no act of his which was in the nature of a breach. That is, of course, assuming that the deposit itself was not wrongful.

The cases contra\(^10\) seem to resent reaching a result so inequitable and ask the question why should a bank which has extended no new credit or put itself in no more unfavorable position than before the deposit was made, be allowed to retain funds in its possession against the beneficial owner merely because it happened to have possession and legal title at a time when it might sustain loss on other debts due it from depositor? And, actually, why should it receive protection at the expense of another when the original loss was not occasioned by that other's acts. The other courts answer "the banker's lien."

The banker's lien originated with the goldsmiths on Lombard Street when banking was in its infancy and the coins deposited were to be kept intact. Since then, it has been incorporated into the law merchant and the common law to apply to modern credit-banking. Some states do not recognize it.\(^11\) The principle upon which it seems to have been first sustained is that it is partly upon the faith of moneys and securities coming into possession of the banker in the

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\(^9\) Negotiable Instruments, Brannan 4th Ed. §25. "Value is any consideration sufficient to support a simple contract. An antecedent or pre-existing debt constitutes value. . . ."


\(^9\) Appeal of the Liggett Spring and Axle Co. Limited, 111 Pa. St. 291, 2 Atl. 685 (1886). "How a custom of this kind could obtain in the face of a well established legal principle we cannot conceive, for an elementary condition of a custom is that it be lawful, and without this it is vicious and void."
future course of general dealings that credit is extended. This principle has persisted in spite of the modern requirement of specific security for cash loans.

A loose use of the term banker's lien has resulted in much confusion. In the case of a general deposit as contrasted with a pledge, it is more accurate to use the term a right of set-off, since the title to funds deposited is in the bank, and what remains to the depositor is merely a chose in action. This right of set-off, as has been seen, does not attach upon special deposits, or deposits with notice of fiduciary character. Since the depositor retains only a claim against the bank for an equivalent amount of money to that deposited, if the money was of fiduciary character, he holds this claim in trust for the beneficiary. It is against this claim that the right of set-off is exercised. Courts, however, have continued to say that the bank has a lien on all funds deposited.

The question, therefore, narrows down to the limits beyond which the so-called banker's lien or set-off should not be extended. It is submitted that in the case where the bank has not changed its position in reliance upon a deposit made by one in a fiduciary relation, unknown to the bank, the minority view is more consistent with modern commercial and banking practice, and fairer to all parties concerned.

HARRY ROCKWELL.

Russell v. Hadduck, 3 Gilman (Ill.), 233 (1846). "The true principle upon which banker's liens must be sustained is there must be a credit given upon the credit of the securities either in possession or expectance"; in re Tallassee Mfg. Co., 64 Ala. 567 (1879); Jones on Liens, 261. "The collecting bank cannot, however, maintain a lien if it has made no advance and given no credit on account of paper received and collected." Smith v. Bank. Supra note 7.


Perry, Trusts, 6th ed., 122; 34 H. L. R. 468, 472.


Coburn v. Carstarphen, 194 N. C. 368, 139 S. E. 596 (1927). "A set-off is in the nature of a payment or credit when debts are mutual. Set-off exists in mutual debts independent of the statute of set-off. Its flexible character is used in equity to prevent injustice." Dameron v. Carpenter, 190 N. C. 595, 130 S. E. 328 (1925). It is a matter of conjecture whether this attitude would or would not prevail in a case similar to the principal one. The minority view of the question under discussion seems to be the more consistent with the principle here advanced by the court. See comment on Carstarphen case in 76 Pa. L. Rev. 314 (1928).