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Banks and Banking -- Collection Claims against Assets of Insolvent National Banks

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NOTES AND COMMENTS

Banks and Banking—Collection Claims against Assets of Insolvent National Banks.

The National Banking Act directs the comptroller to make ratable distribution of the assets of insolvent national banks.[1] This prevents preferred claims against the assets of an insolvent national bank, except where property is held in trust by the bank,[2] or in situations which justify an application of the equitable doctrine of constructive trust,[3] as where deposits were received at a time when the bank was knowingly insolvent.[4] Thus the owner of an item sent for collection and remittance to a national bank which became insolvent after collecting the item but before remitting the proceeds is in the position of a general creditor, unless he shows, first, that a particular fund has been augmented by the collection transaction, or that the proceeds have been segregated, and, second, that the receiver has acquired the augmented fund or the segregated assets.[5]

State court decisions upon the priority of claims against the assets of banks which have collected items and failed before remitting the proceeds have varied widely. In some states the strict rule which applies to national banks has also prevailed in respect to state banks.[6] In other states the owner of an item sent for collection has been granted a preference, even where the obligor pays the item with a check drawn upon his account in the collecting bank.[7]

[1] 12 U. S. C. A. §194 (1927); "From time to time, after full provision has been made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller may make a *ratable dividend* of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held."

[2] Capital National Bank v. First National Bank of Cadiz, 172 U. S. 425, 19 Sup. Ct. 202, 43 L. ed. 502 (1929); Bartlof v. Millett, 22 F. (2d) 538 (C. C. A. 8th, 1927); Fiman v. State of South Dakota, 29 F. (2d) 776 (C. C. A. 8th, 1928), *cert. denied*, 279 U. S. 841, 49 Sup. Ct. 254, 73 L. ed. 987 (1929).

[3] Townsend, *Constructive Trusts and Bank Collections* (1930) 39 YALE L. J. 980.

[4] St. Augustine Paint Co. v. McNair, 59 F. (2d) 755 (D. C. Fla. 1932); Gering v. Buerstella, 118 Neb. 54, 223 N. W. 625 (1929).

[5] Lucas County v. Jamison, 170 Fed. 338 (C. C. Iowa, 1908); St. Augustine Paint Co. v. McNair, 59 F. (2d) 755 (D. C. Fla. 1932); Note (1934) 44 YALE L. J. 341.

[6] Yesner v. Commissioner of Banks, 252 Mass. 358, 148 N. E. 224 (1925); Zimmerli v. Northern Bank & Trust Co., 111 Wash. 624, 191 Pac. 788 (1920).

[7] Edwards v. Lewis, 98 Fla. 212, 124 So. 746 (1929); Winkler v. Veigel, 176 Minn. 384, 223 N. W. 622 (1929).

Judicial treatment of collection claims upon the assets of insolvent banks is

The American Bankers Association Bank Collection Code, drafted in 1929 and later adopted by eighteen states,[8] was designed to simplify and make uniform the law governing check collections.[9] This code provides that the assets of an agent collecting bank shall be impressed with a trust in favor of the owner of items sent for collection and that such owner shall have a preferred claim upon the bank's assets if it should fail before remittance, irrespective of whether the proceeds of such item can be traced and identified.[10]

Three recent decisions, two in the United States Supreme Court and one in the Circuit Court of Appeals, have held such provisions in state banking laws unconstitutional when applied to national banks, on the ground that they conflict with the ratable distribution provision of the National Banking Act.[11]

In 1934 the Commissioners on Uniform State Laws tentatively adopted the fifth draft of a Bank Collection Act. This act provides that when a collecting bank receives the proceeds of an item for remittance, but closes before remittance is made, the proceeds will be

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discussed at length in Note (1934) 44 YALE L. J. 341, where the various holdings in regard to both state and national banks are carefully analyzed.

[8] Idaho; Illinois; Indiana; Kentucky; Maryland; Michigan; Missouri; Nebraska; New Jersey; New Mexico; New York; Oregon; Pennsylvania; South Carolina; Washington; West Virginia; Wisconsin; Wyoming.

[9] FOREWORD TO AMERICAN BANKERS ASSOCIATION BANK COLLECTION CODE (1929).

[10] Sec. 13 (3): "Where an agent collecting bank other than the drawee or payor shall fail or be closed for business . . . , after having received in any form the proceeds of an item or items entrusted to it for collection, but without such item or items having been paid or remitted for by it either in money or by an unconditional credit given on its books or on the books of any other bank which has been requested or accepted so as to constitute such failed collecting or other bank debtor therefor, *the assets of such agent collecting bank which has failed or been closed for business . . . shall be impressed with a trust in favor of the owner or owners of such item or items for the amount of such proceeds and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank.*"

[11] Old Company's Lehigh v. Meeker, 55 Sup. Ct. 392 (U. S. 1935); Jennings v. United States Fidelity & Guaranty Co., 55 Sup. Ct. 394 (U. S. 1935); Spradlin v. Royal Mfg. Co., 73 F. (2d) 776 (C. C. A. 4th, 1934). While North Carolina has not adopted the Bankers Bank Collection Code a similar provision has been enacted to govern the collection situation. N. C. CODE ANN. (Michie, 1931) §218 (c) ((14)): "Liquidation of Banks: Declaration of Dividends; Order of Preference— . . . Provided, that when any bank, or any officer, clerk, or agent thereof, receives by mail, express or otherwise, a check, bill of exchange, order to remit note, or draft for collection, with request that remittance be made therefor, the charging of such item to the account of the drawer, acceptor, indorser, or maker thereof, or *collecting any such item from any bank or other party, and failing to remit therefor, or the non-payment of a check sent in payment therefor, shall create a lien in favor of the owner of such item on the assets of such bank making the collection,* and shall attach from the date of the charge, entry or collection of any such funds. . . ."

deemed to be held in trust.[12] The trust feature of this act is, of course, subject to the same constitutional objection as the corresponding provisions of the Bankers Collection Code.

The obvious effect of these decisions is to seriously impair the effectiveness of both proposed collection laws and to further accentuate the division of banking into two systems, national and state. It is also an interesting speculation, since the owner of an unremitted item would have a lien upon the assets of an insolvent state bank but not upon the assets of a national bank, whether the courts would consider a collecting agent negligent who sent an item to a national bank for collection and remittance where a state bank was equally available.[13]

To remedy the present situation in the law as to national banks Congressional action will be necessary. Three forms of action are possible. First, Congress may enact either the Bankers Bank Collection Code or the Uniform Bank Collection Act. Second, a statute may be adopted stating the priorities of each of the various classes of creditors who may have claims.[14] Third, an amendment may be made to the National Banking Act giving priority to claims for items collected by national banks but for which remittance was not made before insolvency. The third proposal is the simplest and would work less change and disturbance in the present structure of the law relating to

[12] Sec. 24: *"When a collecting bank receives the proceeds of an item for remittance, but closes before making remittance in the proper form,* and which, if by draft or other remittance item, is not dishonored upon due presentment, *a debtor-creditor relation will not be deemed to exist as to the proceeds but they will be deemed held in trust,* subject to any lien or other interest the bank may have acquired therein. Should the proceeds be in the form of a credit to the bank with a correspondent or with some other bank, or should they not be identified or otherwise traced into specific assets of the closed bank, they will be conclusively presumed to be traced into its general assets, exclusive of previously acquired bank buildings and other real estate and any fixtures or equipment. If such proceeds be received in the form of a draft or other remittance item which upon due presentment is dishonored because the drawer thereof has closed, the bank will not be deemed in receipt of proceeds for purposes of this section but will hold the item at the disposal of its customer."

[13] It has been stated that if two or more courses of collection are open to a collecting bank, one of which may prove damaging to the payee, the bank is liable if damage results from a selection of that course. Federal Land Bank v. Barrow, 189 N. C. 303, 309, 127 S. E. 3, 6 (1925). But it has also been held that where a statute alleviates the strict rule that a check is payable only in cash by authorizing the payment of checks by means of bank exchanges when presented by a Federal Reserve Bank or by mail, a selection of these courses by agent collecting banks do not render them liable for resultant losses. Braswell v. Citizens National Bank, 197 N. C. 229, 148 S. E. 236 (1929); Morris v. Cleve, 197 N. C. 253, 148 S. E. 256 (1929). Both cases are discussed in Note (1929) 8 N. C. L. REV. 55.

[14] See the order of preference contained in the North Carolina Banking Law, N. C. CODE ANN. (Michie, 1931) §218 (c) ((14)). This possible course of Congressional action was suggested by the Commissioners on Uniform State Laws. UNIFORM BANK COLLECTION ACT §24, note.

national banks. It is therefore suggested that the National Banking Act[15] be amended by adding the following italized proviso:

From time to time, after full provision has been made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; ***provided, that when, prior to its closing, such banking association had received an item or items for collection and remittance and had collected the proceeds thereof in any manner but either had not remitted therefor or had remitted by an exchange draft which was dishonored on due presentment because of the closing of such association, the amount of said item or items collected shall constitute a preferred claim on the assets of the association in the comptroller's hands notwithstanding that the proceeds of such item or items cannot be traced into the assets of the bank and cannot be shown to have augmented said assets;*** **and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held.**

Such an amendment to the National Banking Act would simplify the collection situation in respect to national banks by obviating the difficulties of tracing and identifying a constructive trust *res*. It would make uniform the check collection law as to state as well as national banks; and it would assure the protection which the Bankers Collection Code and the Uniform Bank Collection Act were designed to give to both collecting banks and check owners.

However, it is possible that Congress may approve of none of these proposed changes in the national banking laws. It was a current thought twenty years ago that the restrictions imposed by Congress upon national banks would leave them unable to successfully compete with state banks, and that national banks would therefore be driven out of existence. With the creation by Congress of Federal Deposit Insurance[16] the competitive odds appear to favor national banks. Before state banks may enjoy the benefits of insured deposits they must submit to national regulation.[17] Sensing the possibility of virtually making all banks national banks through regulation, Congress may prefer to let

[15] 12 U. S. C. A. §194 (1927). [16] 12 U. S. C. A. §264 (1934).

[17] 12 U. S. C. A. §264 (e) (1934). The effect of this section is to require that state banks join the Federal Reserve System as a prerequisite to the insurance of their deposits.

competition drive the nonconforming state banks out of existence and to retain national banking laws as they presently exist.

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Common Carriers—Railroads—Possibility of Changes in the Law Due to Changed Economic Conditions.

That the law of railroads—and perhaps of other common carriers—is entering upon a period of metamorphosis does not seem to be an extravagant prediction.[1] Rather does it appear to be an almost inevitable conclusion. An unmistakable warning of that change is implicit throughout the opinion of the Supreme Court of the United States in the case of *Nashville, C. & St. L. Ry. v. Walters*.[2] It is not the actual decision in the case which prompts the above prediction; it is the discussion of Mr. Justice Brandeis.

A Tennessee statute imposes upon a railroad one-half the cost of eliminating a grade crossing over its road, when such elimination is ordered by the state highway commission.[3] Plaintiff railroad was ordered to contribute one-half the cost of an underpass at a point where a new federal-aid highway intersected its line. It did not question the power of the state to build the proposed highway; its power to require the separation of grades; the appropriateness of the plan adopted for such separation; nor the reasonableness of the cost. It conceded the settled rule of law that, ordinarily, the state may, under its police power, impose upon a railroad the whole cost of eliminating a grade crossing, or such part thereof as it deems appropriate.[4] It did contend, however, that, in view of special circumstances set forth, the order, and the statute as so applied, were so unreasonable and arbitrary as to deprive it of property without due process of law in violation of the Fourteenth Amendment. The trial court found that, with but one exception, the evidence fully supported every averment of fact in the bill, and upheld plaintiff's contention. The Supreme Court of Tennessee reversed the trial court, holding the statute constitutional upon its face, and declining to consider the special facts relied upon by the railroad.[5] The Supreme Court of the United States decided that the state Court erred in refusing to consider those facts.

The Court summarizes the special facts alleged in the bill as relating to "the revolutionary changes incident to transportation wrought in re-

[1] No attempt will be made herein to predict specific changes.
[2] 55 Sup. Ct. 486 (U. S. 1935).
[3] Tenn. Pub. Acts 1921, c.132; amended by Pub. Acts 1923, c.35; Pub. Acts 1925, c.88.
[4] See 55 Sup. Ct. 486, 487 (U. S. 1935), and cases cited in n. 3.
[5] Nashville, C. & St. L. Ry. v. Baker, 167 Tenn. 470, 71 S. W. (2d) 678 (1934).