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Precedents for Federal Bank Deposit Insurance

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tion is helpless, because the much discussed section 203(d) does not give the President blanket power to override state constitutions." The change of policy on the part of the administration with respect to this provision is very significant. Although Secretary Ickes had previously announced that as a matter of policy the federal government would not make loans to municipalities where such action was prohibited by the state constitution, this statement goes farther and practically admits the complete lack of power to do so.

These considerations point to the conclusion that the attempt by Congress to advance public work funds to any state, county or municipality, notwithstanding any constitutional or legal restriction on the right or power of such state, county or municipality to borrow money or to incur indebtedness is unconstitutional, since it is an encroachment by the federal government upon the sovereign powers reserved to the states.

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PRECEDENTS FOR FEDERAL BANK DEPOSIT INSURANCE

The Banking Act of June, 1933, creates a Federal Deposit Insurance Corporation the stock of which is to be subscribed for by the United States Treasury, the Federal Reserve Banks and members of the Federal Reserve system. Federal Reserve Banks are required to own shares to the amount of one-half of their surplus on January 1, 1933; member banks to the amount of one-half of one per cent of their total deposit liabilities, to be adjusted annually, subject to emergency assessments of an additional one-fourth of one per cent. Dividends may be declared. Upon the closing of an enrolled bank the Corporation is to act as receiver and pay insured depositors 100 per cent of their claims up to \$10,000, 75 per cent thereafter up to \$50,000, and 50 per cent of the amount of the claim in excess of the last sum. It is then subrogated to the rights of these depositors until the amounts of the insurance payments are recovered. The act is to go into effect July 1, 1934. A temporary Deposit Insurance Fund is provided to begin January 1, 1934. State non-member banks may participate in the scheme for a period of two years from this date.¹

This specimen of the new legislation, unlike many of its companion pieces, possesses a definite parentage and history. The guaranty of deposits is not new in state annals; early appear-

¹ 12 U. S. C. 264.

ances in the nineteenth century² were succeeded by remarkably unsuccessful outcroppings during the last three decades.³ They are now for the most part defunct or in process of liquidation.⁴ Numerous controversies have arisen, and a number of judicial decisions have clustered about certain mooted points. Many similar questions are likely to rearise in connection with similar provisions of the present act. It is the purpose of this note to examine these questions chiefly in the light of the answers which have already been given. The parallel, of course, cannot be regarded as perfect; it is, however, the best and most definite standard of prediction at the present time.

There can be little apparent doubt as to the power of Congress to create such a corporation under the extremely broad banking powers early enunciated in *McCulloch v. Maryland*.⁵ From that time up to the present, Congress' excursions into the field of banking have been, in the main, upheld with little question by the federal courts.⁶ A superficial parallel suggests itself between the Federal Reserve System and its compulsory reserves and the instant act with its compulsory subscriptions to the Insurance stock. The former has been upheld against the protests of a member bank.⁷ In the past, however, most attacks upon the Federal Reserve system have been from without; whereas, judging from the almost universal history of state guaranty schemes, the future will see a number of complaints by solvent member banks that they are being levied upon for the benefit of depositors of failed or weak institutions.

The question of due process will most probably arise. What cogency will it possess? It must be noted that although the Supreme Court has allowed Congress a most extensive discretion in choosing the means of carrying out its banking powers, never

² *In re Lee Bank* (1860) 21 N. Y. 9; *In re Reciprocity Bank* (1860) 22 N. Y. 9; *Elwood v. Treasurer of Vermont* (1851) 23 Vt. 701; *Receiver v. State Treasurer* (1866) 39 Vt. 92.

³ Oklahoma in 1907 (*Snyder's Comp. Laws* 1909, pp. 241-244); Kansas in 1909 (*Gen. Stat. Kan.*, 1915, chap. 11, art. 2, secs. 595-612); Nebraska in 1909 (*Laws Neb.* 1909, chap. 10, p. 66); Texas in 1909 (*Rev. Stat.* 1911, arts. 445-517); South Dakota in 1915 (*Rev. Code* 1919, secs. 9005-9031); Mississippi in 1915 (*H. Ann. Miss. Code* 1917, sec. 2591); Washington in 1917 (*Pierce's Code* 1919, secs. 333-354); North Dakota in 1917 (*Sess. Laws* 1917, chap. 26, p. 177). For a thorough digest and comparative discussion of these acts see *Federal Reserve Bulletin*, Sept. 1925, pp. 626-668.

⁴ See *A. Butts Guaranty of Bank Deposits in Eight States* (1931) 3 *Miss. Law Journal* 186.

⁵ (1819) 4 *Wheat.* 316.

⁶ *Osborn v. Bank of United States* (1824) 9 *Wheat.* 738; *First Nat. Bank v. Fellows* (1917) 244 U. S. 416; *Smith v. Kansas City Title & Trust Co.* (1921) 255 U. S. 180; *Westfall v. United States* (1927) 274 U. S. 256. See also *Veazie Bank v. Fenno* (1869) 8 *Wall.* 533; *Legal Tender Cases* (1871) 12 *Wall.* 457; *Juilliard v. Greenman* (1884) 110 U. S. 421.

⁷ *First Nat. Bank v. Murray* (1914) 212 *F.* 140.

has this discretion been declared unlimited. The wording in *McCulloch v. Maryland* is significant, "all means which are appropriate, which are plainly adapted to that end."⁸ A recent decision interprets this as acknowledging the power of Congress to act "within the limits of a just discretion."⁹ With a notorious exception¹⁰ the court has been loath to challenge Congress for abuse of this discretion. Might its policy alter in the event the present scheme proves impractical and burdensome upon solvent members? In the light of the signally unsuccessful state guaranty acts the question is of more than academic significance. Answer is aided by a series of important decisions in which the Supreme Court passed upon the constitutionality of these acts, and in which can be seen a growing tendency to limit legislative discretion in this particular.

The classic case of *Noble State Bank v. Haskell*¹¹ arose from an attempt to enjoin the State Banking Board of Oklahoma from collecting an assessment which amounted to two per cent of the bank's total deposit liabilities. Upon the issue of due process the constitutionality of the guaranty act was upheld as a valid exercise of the police power. On a motion for a rehearing in which the impracticality of so large an assessment was urged, the court, through Mr. Justice Holmes, replied: "We fully understand the practical importance of the question and the very powerful argument that can be made against the wisdom of the legislature, but on that point we have nothing to say, as it is not our concern." He added that in any case "there is no out and out unconditional taking at all" as "payment can be avoided by going out of the banking business."¹² This decision controlled several subsequent cases.¹³

A new and for present purposes significant criterion was introduced in the recent case of *Abie State Bank v. Bryan*.¹⁴ Here the plaintiff in its own name and on behalf of several hundred other state banks of Nebraska sought to enjoin the collection of assessments totaling six-tenths of one per cent of their deposit liabilities. It was urged that the guaranty law no longer served any rational public purpose, and in practice merely took away from the security of depositors in going banks in order to pay depositors of an ever increasing number of failed banks. It was

⁸ *Supra*, n. 5 at p. 421.

⁹ *First Nat. Bank v. Fellows*, *supra*, n. 6 at p. 419.

¹⁰ *Hepburn v. Griswold* (1870) 8 Wall. 603 (the first legal tender case).

¹¹ (1911) 219 U. S. 104.

¹² *Supra*, n. 11 at p. 580.

¹³ *Shallenberger v. State Bank* (1911) 219 U. S. 114 (the Nebraska act); *Assaria State Bank v. Dolley* (1911) 219 U. S. 121 (Kansas); *Abilene Nat. Bank v. Dolley* (1913) 228 U. S. 1 (Kansas).

¹⁴ (1931) 282 U. S. 765.

found as fact by the trial court that two-thirds of the banks, under existing conditions, were unable to pay compensatory dividends after paying assessments which amounted to 8 per cent of their capital. During the pendency of the appeal the legislature provided a plan of liquidating the guaranty scheme and reduced future assessments to a maximum of two-tenths of one per cent for a period of only ten years. The court held that it was not precluded by an earlier decision from holding the measure invalid since "a police regulation, although valid when made, may become, by reason of later events, arbitrary and confiscatory in operation."¹⁵ Further, the fact that the banks had exercised their option of remaining state banks rather than ceasing to do business or becoming members of the national system, did not estop them from assailing the constitutionality of the act, since "The fact that a choice was made according to interest does not exclude duress."¹⁶ In the light of the intervening legislation, however, the injunction was denied: "Considering the reduction in the extent of the obligation as to future assessments, we are unable to say that the statute in this modified form is confiscatory, or other than a reasonable method of liquidating the guaranty plan."

The implications here are two-fold. There is no longer present, as there might have been under the earlier decisions, an easy solution of constitutional difficulties in the argument that a member bank by remaining in the Federal Reserve system will waive its rights to objections under the due process clause. More important is the tendency here evinced to construe the powers of the state legislatures more strictly and to look more closely into the practicality of the means employed by them. The parallel between the *Abie* decision and the present problem is not perfect, but it is persuasive. In view of this tendency, the possibility of the court's challenging the recent banking legislation, although remote, is not beyond reason.

A question of more detail is that of the depositor's rights under a guaranty act. It has been held generally that the depositor has no vested interest in the guaranty funds which the legislature cannot alter by subsequent statutes;¹⁷ no contract duty is owing him, rather he is the beneficiary of a bounty—"an act of grace by the legislature, so far as the depositors were concerned."¹⁸ Hence

¹⁵ *Lincoln Gas & Electric Co. v. City of Lincoln* (1919) 250 U. S. 256; *Allen v. St. Louis, Iron Mt. R. Co.* (1913) 230 U. S. 553; *Smith v. Illinois Bell Tel. Co.* (1930) 282 U. S. 133.

¹⁶ See, *A. T. & S. F. R. Co. v. O'Connor* (1912) 223 U. S. 280; *Union Pac. R. Co. v. Public Service Comm. of Mo.* (1918) 248 U. S. 67.

¹⁷ *Wirtz v. Nestos* (1924) 51 N. D. 603, 200 N. W. 524.

¹⁸ *Abie State Bank v. Bryan*, *supra*, n. 14, at p. 783; *Wirtz v. Nestos*, *supra*, n. 17.

a guaranteed depositor cannot complain if, subsequent to the failure of his bank and the allotment of his claim, which was to enjoy priority according to the time at which his bank had failed, the legislature abolishes this order of precedence and prorates the total amounts payable.¹⁹ Again, depositors in failed banks who hold certificates of indebtedness issued against the guaranty fund are not legally injured by a repeal of the law in spite of the fact that this may leave their claims unsatisfied.²⁰ It is suggested, however, that one form of vested right may arise—the right of all who possessed valid demands against the fund when money came into it to have so much of that money divided among them as is necessary to meet their demands; until then the legislature cannot appropriate the funds for other uses.²¹

Matters of priority have provided frequent subjects for debate. The present Federal act declares that upon paying insured depositors the Corporation “shall be subrogated to all rights against the closed banks of the owners of such deposits and shall be entitled to receive the same dividends from the proceeds of the assets of such closed bank as would have been payable to each such depositor. . . .”²² Certain of the state acts gave express preference to the claims of insured depositors.²³ In other states where, as in the present act, no such express provision was included, attempts were made to read from the purpose of the acts an implied preference. This the courts refused to do.²⁴ Indeed, in one jurisdiction the court went to far as to disregard an expressly granted preference.²⁵

About the definition of the word “depositor”²⁶ has centered a group of decisions the number of which, considering the relatively few states and short period in which the guaranty laws were in force, is extraordinarily large. The usual description is of little practical value: “A depositor is one who delivers to or leaves with a bank money, or checks and drafts, the commercial equivalent of money, subject to his order, and by virtue of which action the title to the money passes to the bank.”²⁷ A clue to the actual meaning follows: “The law will look through all semblances and forms to ascertain the actual fact as to whether or not there has been a bona fide deposit made.”²⁸ The distinction between a de-

¹⁹ *Wirtz v. Nestos*, supra, n. 18.

²⁰ *State v. Smith* (N. D. 1931) 234 N. W. 764.

²¹ *Ibid.*, at p. 781.

²² 12 U. S. C., sec. 264 (L).

²³ *Lankford v. Oklahoma Engraving Co.* (1913) 35 Okla. 404, 130 Pac. 278.

²⁴ *State v. Duke* (1922) 120 Wash. 13, 206 P. 918.

²⁵ *Anderson v. Baskin & Wilbourn* (1917) 114 Miss. 81, 74 So. 682.

²⁶ 12 U. S. C. sec. 264 (L).

²⁷ *Kidder v. Hall* (1923) 113 Tex. 49, 251 S. W. 497, at p. 56.

²⁸ *Ibid.*, at p. 58.

posit and a loan to the bank is particularly troublesome; both create the debtor-creditor relationship;²⁹ solicitation on the part of the bank is not of itself evidence of a loan;³⁰ nor the fact that the certificate of deposit is payable only at a future date and not subject to check;³¹ one suggested distinction is that the payment of a loan must be tendered by the bank at maturity, whereas the deposit remains until withdrawn.³² This, however, is a merely mechanical rule; actual decisions are controlled by considerations of the actual intent of the parties and the policy of the act.³³ Certain typical and often recurring situations can be described.

Frequently stockholders or directors knowing their bank is in a precarious situation will make large "deposits" on the very eve of insolvency, hoping thus both to save their institution and to come under the protection of the guaranty laws. The methods used to encompass these ends are at times almost humorously devious. In most cases the courts have seen through the subterfuge and pronounced these transactions "loans."³⁴ In Nebraska they were expressly excluded by statute.³⁵ Where the bank agrees to pay the depositor a "bonus" in excess of the legal interest rate on deposits the entire deposit is removed from protection.³⁶ Where, however, a third person interested in the success of the bank pays the bonus, or where the depositor in good faith believes a third person is paying it, the deposit is held good, on the principle that it is desired only to exclude express agreements for excess interest between bank and depositor.³⁷ In pursuance of this exception a deposit on which the cashier of the bank paid a "bonus" was held good—surely a failure on the part of the court to "look through all semblances."³⁸ Where a deposit is made under circumstances excluding it from the benefits of the guar-

²⁹ *State v. Smith*, *supra*, note 20.

³⁰ *State v. Wayne County Bank* (1924) 112 Neb. 792, 201 N. W. 907.

³¹ *Shaw v. McBride* (Civil App. Tex. 1928) 9 S. W. 2nd 410.

³² *Ibid.*

³³ "It is not easy to formulate any specific test by which to determine in a given case into which class a transaction falls." *American State Bank v. Wilson* (1922) 110 Kan. 520, 204 Pac. 709, at p. 525; "intention and effect" controls, *Fourth Nat. Bank v. Wilson* (1922) 110 Kan. 380, 204 Pac. 715.

³⁴ *State Banking Board v. James* (Civil App. Tex. 1924) 264 S. W. 145; *State v. Atlas Bank of Neligh* (1926) 114 Neb. 646, 209 N. W. 333; *State v. Farmers' State Bank* (1925) 113 Neb. 348, 203 N. W. 572. But see *State v. Nebraska State Bank* (1929) 118 Neb. 660, 225 N. W. 778 (deposits made in "ordinary course of business").

³⁵ *State v. Atlas Banks*, *supra*, n. 34.

³⁶ *American State Bank v. Wilson* (1922) 110 Kan. 520, 204 Pac. 709; *State v. Atlas Bank* (1925) 113 Neb. 843, 205 N. W. 563.

³⁷ *Farm Mortgage Trust Co. v. Wilson* (1922) 110 Kan. 786, 205 Pac. 610; *Pitts v. People's Bank* (1924) 137 Miss. 240, 102 So. 279.

³⁸ *State v. Wayne County Bank*, *supra*, n. 30.

anty, but is later renewed in a legal form, the renewal is held to cure the defects.³⁹ It has even been held that, where an accumulation of excessive and illegal interest due on the first certificate of deposit is included in the principal of the certificate renewed at a legal rate, the latter is good.⁴⁰ Good faith holders of certificates which do not represent "good" deposits are not protected.⁴¹ There can be seen, however, a tendency to be lenient in interpreting deposit transactions where a good faith holder is concerned.⁴² Cashier's checks are not included,⁴³ unless given in exchange for the holder's check upon his deposit.⁴⁴ Nor are funds held by the bank as collection agent.⁴⁵ There is conflict as to whether special deposits are guaranteed,⁴⁶ logically those who deny protection are more consistent, since the title to such does not pass to the bank.⁴⁷ Where a bank was given Liberty Bonds to exchange for a later issue, converted them and later gave the owner a certificate of deposit in satisfaction of his tort claim, the claim against the guaranty fund was not allowed.⁴⁸ Where, however, the bank when a going concern refused to allow a deposit claim, and the depositor secured a judgment for that amount, he was allowed to partake in the fund to the extent of his judgment and interest thereon.⁴⁹

Many problems other than those mentioned above will undoubtedly present themselves for judicial determination. Indeed, it is recognized that the decisions on which this discussion is based can be only of persuasive, rather than binding, authority. They cannot, however, fail to possess cogency in relation to the many provisions of the Federal act which reproduce in essence the state guaranty plans. When we leave such common denominators, however, and turn to novel clauses in the present act, interpretation on the relatively solid basis of prior decisions must give way to something more nearly approaching pure prophecy—a venture not within the scope of this note.

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³⁹ *Pitts v. People's Bank*, supra, n. 37.

⁴⁰ *State v. American Exchange Bank* (1926) 114 Neb. 626, 209 N. W. 217.

⁴¹ *Fourth Nat. Bank of Wichita v. Wilson*, supra, n. 33; *State v. Kilgore State Bank* (1925) 113 Neb. 772, 205 N. W. 297.

⁴² *Anderson v. Yates* (Miss. 1924) 99 So. 499.

⁴³ *Kidder v. Hall*, supra, n. 28.

⁴⁴ *Middlehauff v. State Banking Board* (1922) 111 Tex. 561, 242 S. W. 442.

⁴⁵ *Lankford v. Shroeder* (Okla. 1915) 147 Pac. 1049.

⁴⁶ *Guaranteed, Johnson v. Johnson* (1924) 134 Miss. 729, 99 So. 369; *Spry v. Huning* (1923) 46 S. D. 237, 191 N. W. 833; not guaranteed, *Tyler County State Bank v. Rhodes* (Civil App. Tex. 1923) 256 S. W. 947.

⁴⁷ *Kidder v. Hall*, supra, n. 27.

⁴⁸ *Hall v. Conaway* (Tex. Civ. App. 1923) 252 S. W. 1105.

⁴⁹ *State v. Citizens' State Bank* (1927) 115 Neb. 593, 214 N. W. 6.