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Trust Preferences of Depositors in Bank Insolvencies in West Virginia

R. E. Hagberg
West Virginia University College of Law

TRUST PREFERENCES OF DEPOSITORS IN BANK INSOLVENCIES IN WEST VIRGINIA

The plaintiffs instituted suit for the purpose of having declared as trust funds, deposits made by them after December 22, 1930, the date when the defendant bank was alleged to have become insolvent. Their claims were established as trust claims on that basis, but a similar trust claim of the state was held to take priority and the funds in the hands of the receiver were insufficient to pay the state. *Reams Drug Store v. Bank of Monongahela Valley.*[1]

It was decided in the principal case that a bank is insolvent when unable to pay its debts in the usual course of business.[2] Whether or not the bank was hopelessly insolvent, and whether or not the fact of such insolvency was actually known to its officials, are questions of fact.[3] Findings of fact by the lower court upon conflicting evidence, will not be reversed, and will not be disturbed unless contrary to the plain preponderance of the evidence.[4]

An acceptance of deposits under these circumstances constitutes such a fraud as will entitle the depositor to a preferential claim on the theory of constructive trust if he is able to trace the *res.*[5]

It is settled in this state that, when the relationship of trustee and *cestui que trust* is once established, no subsequent dealing with the trust property by the trustee can relieve it of the trust between him and his *cestui.*[6] So long as the trust fund may be identified either as the original property or its product, equity will pursue it.[7] Where a trustee bank wrongfully commingles the cestui's money with its own, the courts have, as a practical matter, felt compelled to relax the tracing requirements. It is no longer neces-

[1] 174 S. E. 788 (W. Va. 1934). Other points passed upon by the court are noted *infra.*

[2] Parker v. Bank, 96 Okla. 70, 220 Pac. 39 (1923); State v. Childers, 202 Iowa 1377, 212 N. W. 63 (1927).

[3] Cronkleton v. Ebmeir, 38 F. (2d) 748 (C. C. A. 8th, 1930).

[4] Hedrick v. Daly, 112 W. Va. 413, 164 S. E. 779 (1932); First Nat. Bank v. McCloud, 112 W. Va. 537, 165 S. E. 799 (1932); Brown v. Brown, 111 W. Va. 324, 161 S. E. 555 (1931). Although the rule seems clear enough the difficulty of proof of insolvency is a serious practical problem for counsel.

[5] Board of Supervisors v. Bank, 138 Va. 333, 121 S. E. 903, 37 A. L. R. 604 (1924); Pennington v. Third Nat. Bank, 114 Va. 674, 77 S. E. 455 (1913); Cherry v. Territory, 17 Okla. 221, 89 Pac. 192 (1906); Williams v. Trust Co., 104 App. Div. 251, 93 N. Y. Supp. 821 (1905); see also Notes (1922) 20 A. L. R. 1206 and (1932) 81 A. L. R. 1078 for list of cases.

[6] Marshall's Ex'r. v. Hall, 42 W. Va. 641, 26 S. E. 300 (1896); Murray v. Sell, 23 W. Va. 475 (1884).

[7] Marshall's Ex'r v. Hall, *supra* n. 6.

sary to identify the specific *res;* it is sufficient to trace it into the bank's general funds and establish an augmentation of the bank's assets.[8] Trust claimants can recover at most, however, the lowest cash balance of the bank during the interim between the wrongful commingling and the receivership.[9] The *cestui* has a charge or lien against the commingled fund.[10] The cash in the bank at the time of its suspension and the cash deposits in correspondent banks are to be considered as part of this fund.[11] One state at least has gone so far as to permit a preference against all of the assets including the proceeds of real estate, buildings and fixtures.[12] This extension is unwarranted as it ignores elementary trust principles and harshly affects the interests of general creditors. When the bank withdraws money for its own purposes, it is presumed that it withdrew its own portion first and the balance remaining is subject to the trust.[13] This presumption will not be exercised so as to defeat the trust.[14] There is some authority to the effect that the presumption is not applicable to a trust *ex malificio*[15] but the weight of authority is otherwise.[16]

As between the depositor and the bank, the ordinary presumption is, that money paid in is paid out in the same order iu which it was deposited.[17] The plaintiffs in the principal case in

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[8] Terre Haute Trust Co. v. Scott, 181 N. E. 369 (Ind. App. 1932); Andrews v. Savings Bank, 209 Iowa 1147, 229 N. W. 907 (1930); Pennington v. Third Nat. Bank, *supra* n. 5. See also Note (1933) 82 A. L. R. 125 for long list of cases.

[9] James Rosco (Bolton) Limited v. Winder, 1 Ch. 62 (1915); see also SCOTT, CASES ON TRUSTS (2d ed. 1931) 495.

[10] Terre Haute Trust Co. v. Scott, *supra* n. 8; Forsythe v. Nat. Bank, 185 Minn. 255, 241 N. W. 66 (1932); Bank v. Millspaugh, 314 Mo. 1, 282 S. W. 706 (1926); Bank v. Peters, 139 Va. 45, 123 S. E. 279 (1924); Yellowstone County v. Bank, 46 Mont. 439, 128 Pac. 596 (1912); Whitcomb v. Carpenter, 134 Iowa 227, 111 N. W. 825 (1907).

[11] Reichert v. United Savings Bank, 255 Mich. 685, 239 N. W. 393 (1931); Meyers v. Fed. Res. Bank, 101 Fla. 407, 134 So. 600 (1931); Central Trust Co. v. Mullens, 108 W. Va. 12, 150 S. E. 137 (1929). This is subject, of course, to the correspondent bank's right to offset its claims against the defunct bank. The presumption should be rebuttable since it might be shown that no part of the credit with a correspondent bank was based on the commingled fund, as where the credit with a correspondent was based entirely upon transactions prior in time to the wrongful commingling.

[12] State *ex rel.* Sorenson v. Farmers' Bank, 237 N. W. 857 (Neb. 1931).

[13] See exhaustive collection of cases in Note (1933) 82 A. L. R. 141-144.

[14] Note (1933) 82 A. L. R. 160.

[15] Yesner v. Com'r. of Banks, 252 Mass. 358, 148 N. E. 224 (1925); Rugger v. Hammond, 95 Wash. 85, 163 Pac. 408 (1917); Nixon v. Bank, 180 Ala. 291, 60 So. 868 (1913).

[16] *Supra* n. 13.

[17] Clayton's Case, 1 Meriv. 572, 35 Eng. Rep. 781 (1816). The court in the principal case compares the positions of a depositor of $2000 before in-

order to establish as large trust claims as possible urged that rule be applied to withdrawals made during the insolvency period. The court, however, discarded the presumption and relied on another to the effect that the bank would act rightfully, and as the depositors drew on their accounts, return the wrongfully accepted deposits. The result of the principal case is to improve the relative position of the general depositor at the expense of a general depositor who is also asserting a trust claim, since the former is allowed, in effect, to share the trust fund of the latter. The court's presumption is an obvious fiction. In honoring checks after insolvency the bank is acting in the normal manner and the presumption appropriate to such dealings should be applied.

Generally, deposits of checks on the bank itself are treated as an augmentation of assets.[18] But the court in the principal case adopted the minority view that assets are not increased as there is nothing more than a shifting of book credits.[19] If the depositor had cashed the check and then deposited the money he would have been able to assert his claim. Why make him go through these useless motions in order to protect himself? Indirectly the court is again permitting the general creditor to share in that which is properly a part of the trust res. In *County Court of Monongalia County v. Bank of the Monongahela Valley*,[20] three banks merged leaving the surviving bank, which later failed, with county deposits of $160,000. The legal maximum of county deposits being $100,000 the court held that the excess of $60,000 was an illegal deposit and constituted a trust fund in behalf of the county. In fact this transaction was no more than a shifting of book credits although it was treated like an original deposit. This case is weakened as an analogy because the cases do not require

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solvency and a depositor of $1000 before and $1000 after, if the first in, first out doctrine were applied. The example is not persuasive since the first depositor was never entitled to any other rights than those incident to the debtor-creditor relationship.

[18] Miami v. First Nat. Bank, 58 F. (2d) 561 (C. C. A. 5th, 1932); Tooele County Board of Educ. v. Hadlock, 11 Pac. (2d) 320 (Utah 1932); Trust Co. v. Bank, 37 Wyo. 216, 260 Pac. 534 (1921); Bank v. Millspaugh, *supra* n. 10; Bank v. Peters, *supra* n. 10; Goodyear Tire & Rubber Co. v. Hanover State Bank, 109 Kans. 772, 204 Pac. 992 (1921); the latter two cases were cited with approval upon a slightly different proposition in Central Trust Co. v. Mullens, *supra* n. 11.

[19] See list of cases in Note (1933) 82 A. L. R. 101.

[20] 112 W. Va. 476, 164 S. E. 659 (1932). For a discussion of this case see (1932) 39 W. VA. L. Q. 180.

augmentation and tracing when illegal deposits of funds of a governmental unit are involved.[21]

It has been settled in West Virginia that the state has a preference over common creditors and that sureties of the state deposits may be subrogated to this right.[22] Thus, in the principal case, the deposits of the state prior to December 22d, within the amount of the bonds were simply entitled to a general preference over common creditors. The excess over the bonds becomes a trust fund entitled to trust preference.[23] But as to the amount the state deposited during the insolvency period, the state became a *cestui* just as the plaintiffs did.[24] Express trusts seemingly by consent of counsel for all parties, had been paid, and the state never claimed that preference existed as to those trusts. Should the state's prerogative be extended to include cases where the interests of trust claimants are involved? A *cestui* has a proprietary interest which is quite different from the personal claim of a general depositor. The plaintiffs, having traced their monies to the court's satisfaction, have, theoretically, identified their own property. If there is not enough to pay all trust claims they should share pro rata.[25] That the state's trust claim is given priority over private trust claims goes far to reveal the true function of the construstive trust theory in bank insolvency cases, namely, — to effect preferential treatment where, in the light of banking practice and business needs, justice requires it, regardless of the limitations of common trust principles. In the case of the state's trust preference it is not a matter of an adjustment between individuals but of protecting public interests deemed to outweigh the interests of private trust claimants.

—R. E. HAGBERG.

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[21] San Diego County v. Calif. Nat. Bank, 52 Fed. 59 (C. C. S. D. Cal. 1892) (County funds); Farmer's Savings Bank v. City of Hamburg, 204 Iowa 1083, 216 N. W. 748 (1927) (City funds).

[22] Woodward v. Sayre, 90 W. Va. 295, 110 S. E. 689, 24 A. L. R. 1497 (1922).

[23] Reichart v. Bank, *supra* n. 11.

[24] See cases, *supra* n. 5.

[25] Yesner v. Com'r. of Banks, *supra* n. 15; see also Cunningham v. Brown, 265 U. S. 1, 44 S. Ct. 424 (1923); People v. Trust Co., 175 Cal. 756, 167 Pac. 388 (1917), *Contra, In re* Bolognesi & Co., 254 Fed. 770 (C. C. A. 2d, 1918).