



Volume 39 | Issue 1

Article 10

December 1932

Banks and Banking--Constitutionality of Statute Waiving Preference of State Against Defunct Bank

Kingsley R. Smith

West Virginia University College of Law

Follow this and additional works at: <https://researchrepository.wvu.edu/wvlr>



Part of the [Banking and Finance Law Commons](#)

Recommended Citation

Kingsley R. Smith, *Banks and Banking--Constitutionality of Statute Waiving Preference of State Against Defunct Bank*, 39 W. Va. L. Rev. (1932).

Available at: <https://researchrepository.wvu.edu/wvlr/vol39/iss1/10>

This Recent Case Comment is brought to you for free and open access by the WVU College of Law at The Research Repository @ WVU. It has been accepted for inclusion in West Virginia Law Review by an authorized editor of The Research Repository @ WVU. For more information, please contact ian.harmon@mail.wvu.edu.

RECENT CASE COMMENTS

BANKS AND BANKING — CONSTITUTIONALITY OF STATUTE WAIVING PREFERENCE OF STATE AGAINST DEFUNCT BANK. — Upon the failure of a bank having state funds on deposit, a proceeding in mandamus was instituted to compel the receiver of the bank to prefer the state over all other creditors. The Supreme Court of Appeals issued the writ, relying on the common law prerogative of the sovereign.¹ By a statute operative January 1, 1931,² the state expressly waived its preference,³ but this was held void

¹This common law priority did not devolve upon the Federal Government, but § 3466 of the Revised Statutes definitely gave it that right. *U. S. v. State Bank of N. C.*, 6 Pet. 29, 8 L. ed. 308 (1832). The Bankruptcy Acts did not affect the priority. *Lewis v. U. S.*, 92 U. S. 618, 23 L. ed. 513 (1875). But the Federal Government is not entitled to priority against the assets of an insolvent national bank. *Cook County National Bank v. U. S.*, 107 U. S. 445, 2 S. Ct. 561 (1883). And it seems to be the majority rule that the prerogative right, being an attribute of sovereignty, is possessed by the state alone and not by a county or other political subdivisions of a state. See notes (1925) 36 A. L. R. 640 and (1928) 52 A. L. R. 755. But the county may get such priority by a special statute, or if the county money is unlawfully deposited, a preference is usually given on the trust theory. *Watts v. Cleveland County*, 21 Okla. 231, 95 Pac. 771, 16 L. R. A. (N. S.) 918 (1908). West Virginia held this priority inapplicable to a county in *County Court v. Matthews*, 99 W. Va. 483, 129 S. E. 399 (1925).

There is a split among the states whether, in the absence of statute, the state is entitled to this preference. Most courts allowing this preference base their decision, as the West Virginia court did, on the sovereign prerogative, or on the theory that depositing public funds constitutes a trust which may be enforced against the receiver or assignee of the insolvent debtor. *Pago County v. Rose*, 130 Ia. 296, 106 N. W. 744, 5 L. R. A. (N. S.) 886 (1906); *Wendell v. Jackson*, 8 Wend. 183, 22 Am. Dec. 635 (N. Y. 1831); *Lansing v. Smith*, 4 Wend. 9, 21 Am. Dec. 89 (N. Y. 1829); *People v. Herkimer*, 4 Cow. 345, 15 Am. Dec. 379 (N. Y. 1825); *Orem v. Wrightson*, 51 Mo. 34, 34 Am. Rep. 286 (1878).

If the depositing of state money was in violation of law and the bank knew this, the state will be given a preference. *Phillips v. Gillis*, 98 Kan. 383, 158 Pac. 23, 29 L. R. A. 1917A, 680 (1916).

Some courts require that this preference be asserted by the state before the appointment of a receiver if the receiver acquires title to the assets, but others ignore such a requirement. *State v. First State Bank*, 22 N. M. 661, 167 Pac. 322, L. R. A. 1918A, 394 (1917) state held not entitled to the preference after receiver was appointed on theory the preference exists in favor of the state only so long as title to the money or property remains in the debtor); *Aetna Accident and Liability Co. v. Miller*, 54 Mont. 377, 170 Pac. 760, L. R. A. 1918C, 954 (1918) (priority held not lost by failure of state to assert it until after appointment of a receiver).

²The act waiving the preference took effect January 1, 1931; on January 28, 1931, an act was passed postponing the operation of this act until January 1, 1933.

³W. VA. REV. CODE (1931) c. 12, art. 4, § 10. *Woodward v. Sayre*, 90 W. Va. 295, 110 S. E. 689, 24 A. L. R. 1497 (1922) held this priority still effective in West Virginia by virtue of article 8 § 21 of the state constitution, which provides for the continuation in this state of all common law rules in force therein at the time the constitution took effect and not repugnant thereto,

as violating article 10, section 6 of the West Virginia Constitution, which reads: "The credit of the State shall not be granted to, or in aid of any county, city, township, corporation or person." *Lawson v. Charter*.⁴

The following transactions have been either held void as against the state or unconstitutional because in violation of a provision of a state constitution which prohibited the lending of state credit to private corporations or individuals: an act of the Missouri Legislature authorizing the issuance of its bonds by way of donation to a private manufacturing corporation;⁵ bonds issued by the State of Arkansas to aid a private railway;⁶ an act authorizing the issuance of state bonds and the use of the money from their sale for the purchase of a farm by a war veteran, to be turned over to him on long term credit;⁷ granting of state credit to a sugar-making corporation;⁸ a Farm Loan Act establishing a department of farm loans to make secured loans on nonurban property and to sell bonds evidencing such lendings;⁹ appropriations of public money to be lent to farmers whose crops had been destroyed.¹⁰ These cases are typical of the evil to which constitutional provisions against lending state credit have uniformly been construed to apply, — the subsidy of private business.

In *U. S. Fidelity & Guaranty Co. v. Central Trust Co.*, 95 W. Va. 453, 121 S. E. 430 (1924) it was held that the state does not lose this preference by taking security to cover its deposits in a bank. The majority of cases agree with this, but it is difficult to see why the preference is not waived by taking security which amply protects the deposits and renders the priority superfluous. See 24 A. L. R. 495. The revisers' note to the above-cited code provision states that it was the express purpose of that section to abrogate the rule announced in the *Woodward and Trust Co.* cases above, and to place the state on a parity with other unsecured creditors.

It is interesting to note that at the time the New Code took effect the depression was taking a heavy toll in the banking world. Accordingly the Legislature in 1931 deferred the waiver of the state's preference until February 1, 1933. See W. Va. Acts of 1931, c. 17.

⁴ *Lawson v. Charter*, 161 S. E. 831 (W. Va. 1932).

⁵ *Cole v. La Grange*, 113 U. S. 1, 5 S. Ct. 416 (1885).

⁶ *McKittrick v. Arkansas Central Railway Co.*, 152 U. S. 473, 14 S. Ct. 661 (1894) (Arkansas constitution of 1864 contained no requirement that popular sanction expressed at a valid election precede the granting of state aid to private enterprises. In 1867 an act was passed granting such aid, with no provision for the approval of voters. The 1868 constitution did, however, contain this requirement, and the court held the second constitution withdrew all authority given in previous statutes to lend state credit without first obtaining the consent of the people, so the 1867 act was declared void).

⁷ *Veterans' Welfare Board v. Jordan*, 189 Cal. 377, 208 Pac. 284, 22 A. L. R. 1515 (1922).

⁸ *Omard Beet Sugar Co. v. State*, 73 Neb. 66, 102 N. W. 80, 105 N. W. 716 (1905).

⁹ *Hill v. Rae*, 52 Mont. 378, 158 Pac. 826, L. R. A. 1917A, 495 (1916).

¹⁰ *William Deering & Co. v. Peterson*, 75 Minn. 118, 77 N. W. 568 (1898).

There is unquestionably a debtor-creditor relation created when state funds are deposited in a bank, but it seems that the constitutional provision was directed against public subsidies for private ventures and not against using banks as depositaries of public funds with the usual incidents of the bank-depositor relation. It thus appears that the constitutional provision was inapplicable to this situation, and it follows that there was no conflict between that provision and the section in the Revised Code of 1931 abolishing the common-law preference of the state. Followed to its logical conclusion, the view adopted in the principal case leads to the questionable doctrine that state funds can *never* be lawfully deposited in banks, for that act (under this decision) *ipso facto* constitutes a pledging of the credit of the state in contravention of the constitution.

The reason given for the rule adopted may also be questioned. There seems to have been no substantial reason for planting the ancient common law rule that "the king can do no wrong" in this country. In the absence of statute, to justify a preference a court might frankly assert that the integrity of public funds is an interest meriting greater legal protection than the funds of individuals. It sounds artificial to say to-day that where the state and individuals are creditors of an insolvent debtor, state funds are given a preference over individual deposits because at common law the king could do no wrong.

Nor is the rule of state preference itself above criticism. The weight of authority unquestionably holds the state is entitled to this preference over private creditors whose claims are on the same footing.¹¹ The state can always secure its deposits by taking corporate surety bonds. The majority rule permits the state to ignore this safeguard and then, if the bank fails, to protect itself at the expense of general depositors who had no opportunity to protect their deposits, and who are thus forced to pay for the negligence of the state officials. Several states have repudiated the theory of state preference,¹² and others have held statutes con-

¹¹ Maryland Casualty Co. v. Rainwater, 173 Ark. 103, 291 S. W. 1003, 51 A. L. R. 1332 (1927).

¹² Casualty Co. v. Rainwater, *supra* n. 12; Comm'r of Banking v. Chelsea Savings Bank, 161 Mich. 691, 125 N. W. 424, 127 N. W. 351 (1910); Potter v. Fidelity & D. Co., 101 Miss. 823, 58 So. 713 (1911); Henry v. Alexander, 131 Miss. 538, 94 So. 846 (1923); Middlesex County v. State Bank, 29 N. J. Eq. 311 (1878), *aff'd.* in 30 N. J. Eq. 311 (1878); North Carolina Corp. Commission v. Citizens' Bank & T. Co., 193 N. C. 513, 137 S. E. 587, 51 A. L. R. 1350 (1927); Baxter v. Baxter, 23 S. C. 114 (1885),

ferring this priority unconstitutional as impairing contractual obligations.¹³ There is an increasing sentiment against this preference because of its obvious unfairness.¹⁴

—KINGSLEY R. SMITH.

CONTRIBUTION — WHERE ONE JOINT PRINCIPAL PAYS TORT JUDGMENT AGAINST AGENT. — A tract of land was owned jointly by A and B, as executors and trustees of the estate of X, by C, and by D. An agent, Drebert, had charge of the land for all the owners when a tenant, Massey, was killed by electrically charged wire. In an early action a judgment was recovered by the personal representative of the deceased against A and B, as executors and trustees. This was reversed,¹ as a trust estate is not liable for the torts of the trustees who are free from the control of the beneficiaries. Thereafter, another suit was instituted against A and B, and the agent, Drebert. A and B being dismissed from this suit upon a plea in abatement for defective service of process, judgment was taken against Drebert, which with costs was paid by A and B, as executors and trustees. In the principal case A and B and C sued the administrator of D, since deceased, for contribution. *Held*: Rulings of the trial court that contribution between joint tort-feasors is not permitted and that the payment was voluntarily made were error. *Payne v. Charleston National Bank*.²

At common law there was no contribution between joint tort-feasors,³ and because of the unjust effect of the application of the rule in certain cases exceptions have developed,⁴ and the test most

¹³ *Harris v. Walker*, 199 Ala. 51, 74 So. 40 (1917) (right of depositors of an insolvent bank held to have arisen out of a contract with the bank as controlled by a constitutional guaranty then in force. This was held an "obligation of a contract" which could not be impaired by either the constitution or a statute); *Atchafalaya R. & Banking Co. v. Bean*, 3 Rob. 414 (La. 1843) (legislature cannot constitutionally change relative rank of creditors *inter se* by an act subsequent to the creation of the debt.

¹⁴ See the comment on *Central Trust Co. v. Bank of Mullens*, 107 W. Va. 679, 150 S. E. 221 (1929) in (1930) 36 W. VA. L. Q. 278.

¹ *Massey v. Payne*, 109 W. Va. 529, 155 S. E. 658 (1930).

² *Payne v. Massey*, 164 S. E. 252 (W. Va., 1932).

³ *Merryweather v. Nixan*, 8 T. R. 186, 101 Eng. Reprint 1337 (1799); THROCKMORTON'S COOLEY ON TORTS (Student ed., 1930) § 81.

⁴ Where the party was only technically liable, *Chicago Rys. v. R. F. Conway Co.*, 219 Ill. App. 220 (1920); where the ground of liability is negligence in carrying on a lawful business, *Harriban v. City of Des Moines*, 198