Michigan Law Review

Volume 35 | Issue 7

1937

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TRUSTS — TRACING PRINCIPLES APPLICABLE WHERE FUNDS OF TWO OR MORE CESTUIS ARE WRONGFULLY COMMINGLED — Public funds of a school district, of the village of Vassar, and of ten other municipalities were deposited in defendant bank without securing the deposit bond required by statute.[1] After defendant bank had been declared insolvent, the school district intervened and sought to have the amount of its deposit impressed upon the cash assets of the bank as a trust, on the ground that the bank became a trustee ex maleficio. The total of the illegal deposits was greater than the cash on hand and the credits established in solvent correspondent banks at the time the receiver took over the defendant's affairs. *Held*, preference refused. The presumption of rightful withdrawal by the trustee from the commingled fund applies only if the commingled fund equals or exceeds the total of all similar trust funds. Intervenor was left with the standing of a mere general creditor of defendant bank. *Attorney General ex rel. State Banking Commissioner v. Michigan Savings Bank of Vassar*, 278 Mich. 225, 270 N. W. 276 (1936).

Until the early part of the nineteenth century, money which was wrongfully commingled with other money could not be traced into the commingled fund because, as it was said, "money has no earmark." The artificiality and injustice of this rule, when applied to the situation of a wrongful commingling of trust funds by the trustee with his own funds, led to the decision of *In re Hallett's Estate*.[2] The court there held that as a matter of presumption, money withdrawn from the commingled fund by the trustee and dissipated by him should be considered withdrawals of his own money, on the theory that when a man does an act which may be done rightfully, he cannot say that act was done wrongfully. This rule has been generally accepted,[3] and is followed in Michigan.[4] Where, however, the commingled fund consists primarily of funds impressed with a trust, so that the contest is essentially between the cestuis themselves, the Michigan court held in the principal case, and has held in previous cases,[5] that tracing on a constructive trust theory will not be aided by the presumption of rightful withdrawal. Such holding is manifestly just, as it

[1] 2 Mich. Comp. Laws (1929), § 7112.

[2] In re Hallett's Estate (Knatchbull v. Hallett), 13 Ch. D. 696 (1879).

[3] Cases collected in 65 C. J. 975 (1933); rule discussed in 4 BOGERT, TRUSTS AND TRUSTEES 2678 (1935); annotation in 82 A. L. R. 46 at 141 (1933), stating that the presumption of rightful withdrawal is the majority doctrine; 7 Ann. Cas. 557 (1907); for a general discussion of tracing principles, see Scott, "Money Wrongfully Mingled with Other Money," 27 HARV. L. REV. 125 (1913); and see 26 R. C. L. 1357 (1920).

[4] Sherwood v. Central Michigan Sav. Bank, 103 Mich. 109, 61 N. W. 352 (1894); Wallace v. Stone, 107 Mich. 190, 65 N. W. 113 (1895); Fire and Water Commrs. v. Wilkinson, 119 Mich. 655, 78 N. W. 893, 44 L. R. A. 493 (1899).

[5] American Employers' Ins. Co. v. Maynard, 247 Mich. 638, 226 N. W. 686 (1929); Reichert v. Fidelity Bank & Trust Co., 261 Mich. 107, 245 N. W. 808 (1932); Reichert v. Lochmoor State Bank, 272 Mich. 433, 262 N. W. 386 (1935).

cannot be presumed that the trustee intended to wrong one cestui in favor of another; and a contrary holding would create a preference in favor of one cestui que trust over others of equal equities. Other courts have laid down a similar rule.[6] But there is a decided split in authority as to the manner of division of the commingled fund, assuming that the presumption of rightful withdrawal is inapplicable. As is seen in the principal case and in other Michigan cases,[7] the Michigan court does not divide the fund between the several cestuis que trustent but relegates them all to the status of mere general creditors. A small number of the cases elsewhere have been worked out the same way.[8] In this situation, however, most courts divide the commingled fund between the cestuis que trustent, following one of two methods: (1) by applying the rule of *Clayton's* case, the rule that the first money in is the first money out,[9] or (2) by prorating the fund among the cestuis que trustent in proportion to their respective contributions to the fund.[10] Clearly, the application of the rule that the first money in is the first money out, for the purpose of determining the proper distribution of the commingled fund between the cestuis que trustent, is

[6] Cunningham v. Brown, 265 U. S. 1, 44 S. Ct. 424 (1924); Emigh v. Earling, 134 Wis. 565, 115 N.W. 128, 27 L.R.A. (N.S.) 243 (1908); In re Mulligan, (D. C. Mass. 1902) 116 F. 715; Bragg v. Osborn, 147 Tenn. 381, 248 S. W. 19 (1922); Commonwealth ex rel. v. Tradesmen's Trust Co., 250 Pa. 378, 95 A. 577, L. R. A. 1916C 10 (1915); the court in In re Hallett's Estate, 13 Ch. D. 696 (1879), said by way of dictum that as between several cestuis the rule of Clayton's Case would apply.

[7] American Employers' Ins. Co. v. Maynard, 247 Mich. 638, 226 N. W. 686 (1929); Reichert v. Fidelity Bank & Trust Co., 261 Mich. 107, 245 N. W. 808 (1932); Reichert v. Lochmoor State Bank, 272 Mich. 433, 262 N. W. 386 (1935); and see dictum in Reichert v. United Sav. Bank, 255 Mich. 685, 239 N. W. 393, 82 A. L. R. 33 (1931).

[8] In re Mulligan, (D. C. Mass. 1902) 116 F. 715; Commonwealth ex rel v. Tradesmen's Trust Co., 250 Pa. 378, 95 A. 577, L. R. A. 1916C 10 (1915); Bragg v. Osborn, 147 Tenn. 381, 248 S. W. 19 (1922).

[9] Clayton's Case, 1 Merivale (Ch.) 572, 35 Eng. Rep. 781 (1816). For cases applying this rule of thumb, see In re Stenning, [1895] 2 Ch. 433; Walker & Gilbert v. First State Bank of Alamogordo, 33 N. M. 565, 273 P. 764 (1928); Cohnfeld v. Tanenbaum, 58 App. Div. 310, 68 N. Y. S. 1023 (1901), reversed in 176 N. Y. 126, 68 N. E. 141, 98 Am. St. Rep. 653 (1903), on the ground that one of the two cestuis could not trace into the fund; Hancock v. Smith, 41 Ch. Div. 456 (1889), dictum; 4 BOGERT, TRUSTS AND TRUSTEES 2683 (1935), with a citation of cases at 2684, note 68; 23 COL. L. REV. 567 (1923), stating that the rule generally applied as between two or more cestuis is the rule of Clayton's Case; 3 DUKE B. A. J. 82 (1935), stating that this is almost the only place in which the rule of Clayton's Case has not been discarded; 65 C. J. 977 (1933).

[10] In re Young, (C. C. A. 4th, 1923) 294 F. 1, in a fact situation similar to that in Cunningham v. Brown, 265 U. S. 1, 44 S. Ct. 424 (1924), the court ordered the cestuis que trustent whose money had been returned to them out of the commingled fund to repay it so-prorating could be accomplished; Robertson v. Morrice, 9 Jurist (Eng.) 122 (1842), where the cestuis que trustent joined in bringing the action; Andrew v. Hamilton County State Bank, 207 Iowa 394, 223 N. W. 249 (1929), single cestui que trust allowed a preference subject "to the right of establishment of other similar trusts"; Plano Mfg. Co. v. Auld, 14 S. D. 512, 86 N. W. 21 (1901); 3 R. C. L. 639 (1914); 4 BOGERT, TRUSTS AND TRUSTEES 2683 (1935), with a citation of cases at 2685, note 70; 65 C. J. 977 (1933).

subject to the same criticisms that can be made against the application of the presumption of rightful withdrawal, that is, the ultimate result is the creation of a preference in the common fund in favor of one cestui as against another of identical equities. Admittedly, both rules are mere presumptions imposed by the courts to aid in tracing. Also it is to be remembered that both rules were devised to enable a sole cestui que trust to identify as his, money in a fund composed of money of the cestui and a wrongdoer, and not where the fund is made up of trust funds of other cestuis que trustent. In contrast to the unequal distribution obtained through the use of the presumption that the first money in is the first money out, prorating the commingled fund between the cestuis que trustent concludes in that equality toward which equity constantly strives. Professor Bogert and other legal commentators argue that the pro rata distribution is the better method to follow.[11] Some writers seek to explain the Michigan cases which deny such cestuis any preferential treatment on the ground of a recent tendency to make more strict the tracing requirements.[12] But this trend in Michigan would seem to be denied by the decision that in the case of trusts ex maleficio, cestuis may enforce preference payments not only against cash in the vaults of a trustee bank, but also against cash said bank had on deposit in correspondent banks at the time it suspended.[13] It is submitted that no logical justification can be found for leaving cestuis, in the situation seen in the principal case, upon the footing of general creditors. The Michigan court does not hesitate to decree preferential payment of such cestuis where the common fund is equal to the total of all the trust funds.[14] Nor does it hesitate to do so in the case of a single cestui even where the balance of the commingled fund has dropped below the amount of the trust fund.[15] Thus, to be consistent with its decisions on related problems, the Michigan court should also declare a preferential payment in a case where two or more cestuis of similar trusts trace into a commingled fund, which fund has dropped below the total of the trusts.[16] And, as has been suggested above, a pro rata distribution of the fund between the cestuis would be the more desirable of the two customary methods to follow.

[11] 4 BOGERT, TRUSTS AND TRUSTEES 2686 (1935), "it would seem that the only rule which is supportable on reason and principle is that of distributing the loss proportionately between the funds"; 23 COL. L. REV. 567 (1923), stating that the rule of Clayton's Case is generally applied, but arguing that pro rata distribution would be more equitable.

[12] Masselink, "Bank Collection Items as Preferred Claims," 14 MICH. S. B. J. *292 (1934); 32 MICH. L. REV. 692 (1934); 6 DETROIT L. REV. 47 (1936); but see contra, Hirsch, "Tracing Trust Funds—Modern Doctrines," 11 TEMPLE L. Q. 11 (1936), as to recent trends to moderate tracing requirements.

[13] Reichert v. United Sav. Bank, 255 Mich. 685, 239 N. W. 393, 82 A. L. R. 33 (1931).

[14] Reichert v. United Sav. Bank, 255 Mich. 685, 239 N. W. 393, 82 A. L. R. 33 (1931). This case is strikingly similar to the principal case on its facts.

[15] 6 DETROIT L. REV. 47 (1936), "the recent cases hold uniformly that the smallest balance at any time may be claimed."

[16] For a vigorous argument against leaving such cestuis to come in with general creditors, see annotation, "Following Trust Funds," L. R. A. 1916C 21 at 85, arguing that if the general fund were "less than the total of all the sums due the several beneficiaries, then the entire sum, under such authorities, should still be set apart to satisfy the trusts as far as possible and in preference to the claims of general creditors."