Washington Law Review

Volume 10 | Number 2

4-1-1935

Preference in Bank Deposits

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NOTES AND COMMENTS

PREFERENCES IN BANK DEPOSITS

While it is possible to expressly create a general, a special, or a specific bank deposit, the determination of the type established usually is a matter of construing the intention of the parties from the facts and circumstances surrounding the transaction. No set form is necessary for their validity Like any other contract, the relationship established arises out of the mutual understanding of those creating it.[1]

The Restatement of the Law of Trusts has taken the view that the relationship depends upon the manifest intention of the parties, and that if the money is to be kept or used for the benefit of the depositor or a third person, it is a trust. But if the bank is to pay a similar amount in return, it is a debt.[2]

A general deposit is one generally to the credit of the depositor to be drawn upon by him in the ordinary course of the business,[3] and it is presumed to be general in the absence of a showing to the contrary [4] The money becomes the property of the bank the moment it is deposited, and the legal relationship of debtor and creditor is established;[5] so that upon insolvency the depositor is entitled to only a pro rata share in the remaining assets. This is also true even though it is a deposit of trust funds by a trustee as long as the deposit is not wrongfully made, the trustee being merely a creditor of the bank in his fiduciary capacity [6]

On the other hand, preferences are granted, in the case of a special deposit which is said to be one for the safe-keeping of money or property, with the identical thing to be returned intact;[7] or in the case of a specific deposit where there is no intention that the identical money is to be returned, but that a similar amount of money is to be used for a particular purpose not involving general credit.[8] No difficulty is experienced in permitting a priority in

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Dearborn v. Washington Sav. Bank, 13 Wash. 345, 42 Pac. 1107 (1895) *Fogg v. Tyler* 109 Me. 109, 82 Atl. 1008, Ann. Cas. 1913E 41, 39 L. R. A. (N. S.) 847 (1912) *Carlson v. Kies*, 75 Wash. 171, 134 Pac. 808, 47 L. R. A. (N. S.) 317 (1913) *Northern Sugar Corp. v. Thompson*, 13 Fed. (2d) 829 (1926).

[2] Restatement of the Law of Trusts, sec. 15, comment h.

[3] *Blake v. State Savings Bank*, 12 Wash. 619, 41 Pac. 909 (1895) *Fogg v. Tyler* note 1, *supra*; *Carlson v. Kies*, note 1, *supra*, 3 R. C. L., sec. 146, 7 C. J., sec. 305.

Shute v. Hinman, 34 Ore. 578, 56 Pac. 412, 47 L. R. A. 265 (1899) *Officer v. Officer* 120 Ia. 389, 94 N. W 947, 98 A. S. R. 365 (1903) *Carlson v. Kies*, note 1, *supra*, *Washington Shoe Mfg. Co. v. Duke*, 126 Wash. 510, 218 Pac. 232, 37 A. L. R. 611 (1923) *Fallgatter v. Citizens' Nat. Bank*, 11 Fed (2d) 383 (1926).

[5] *New York County Nat. Bank v. Massey*, 192 U. S. 138, 24 S. Ct. 199, 48 L. Ed. 380 (1904).

Paul v. Draper 158 Mo. 197, 59 S. W 77, 81 A. S. R. 296 (1900) *Valentine v. Duke*, 128 Wash. 128, 222 Pac. 494 (1924).

[7] *Fogg v. Tyler* note 1, *supra*.

[8] *Kimmel v. Dickson*, 5 S. D. 221, 58 N. W 561, 48 A. S. R. 869, 25 L. R. A. 309 (1894) (fund left at bank to be paid to third person on presentation of warranty deed conveying certain property to depositor) *Ander-*

the case of a special deposit upon a trust theory as there is a definite trust res, but with a specific deposit it is not the general practice nor does the depositor usually consider that a certain definite sum will be set aside and used, but only that a like sum will be applied for the purpose stipulated, with the idea that the money is not to be used by the bank in its own business.[9]

It is the rule in some jurisdictions that a fund impressed with a trust will not be given preference unless the fund can be identified or traced into some specific fund;[10] while in other jurisdictions it is not the requirement that the identical money be traced into the hands of the receiver, if the funds of the bank were increased by the amount of the deposit.[11] In other cases it has been held that, if after the deposit but before insolvency, there has been a decrease in the funds of the bank, a recovery will be permitted as long as the money on hand is equal to or exceeds the amount of the trust.[12] A slightly modified form of this latter doctrine reaches the same result by presuming that the money dispersed by the bank from the time of the making of the deposit to the time of insolvency is its general funds and not the trust fund, or by presuming that if the residue is less than the trust. then such residue is a part of and belongs to the trust fund.[13] This will be true even though it is shown that the funds in the bank are kept up by other deposits which are not withdrawn.[14]

The Washington court has termed a deposit, where the identical thing is to be returned or where the money is to be used for a particular purpose, a special deposit, and has allowed the depositor in each situation a preference thus giving what is factually known in many jurisdictions as a specific deposit the legal effect of a special deposit. In an early case in our jurisdiction,[15] it was said by way of dicta that if the money had been delivered to the bank, not as a general deposit, but for a particular purpose, it would have been a trust. In this same case it was stated that it was not important that the money could not be identified as long as it could be traced to the bank's vaults, and there was a sum equal to it remaining there until insolvency

The first case squarely meeting the problem involving specific

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son v. Pacific Bank, 112 Cal. 598, 44 Pac. 1063, 53 Am. S. R. 228, 32 L. R. A. 479 (1896) (for indemnity for furnishing bail) *Carlson v. Kies*, note 1, *supra*, *Titlow v. Sundquist*, 234 Fed. 613 (1916) (money deposited to pay a mortgage obligation owing to a third person) *Shawmut Corp. v. Bobrick Sales Corp.*, 260 N. Y. 499, 184 N. E. 68 (1933) (to pay a draft).

[9] See 6 Minn. L. R. 306 for a discussion of the possibility of allowing a preference as tenants-in-common on an analogy to the grain cases.

[10] *Shute v. Hinman*, note 4, *supra*; *Clark v. Toronto Bank*, 72 Kan. 1, 82 Pac. 582, 115 A. S. R. 173, 2 L. R. A. (N. S.) 83 (1905). See 16 Harv. L. Rev. 228.

[11] *Enigh v. Earling*, 134 Wis. 565, 115 N. W 128, 27 L. R. A. (N. S.) 243 (1908), 3 R. C. L., sec. 181.

[12] *Massey v. Fisher* 62 Fed 958 (1894) *In re Stewart*, 178 Fed. 463 (1910), *Fogg v. Tyler* note 1, *supra*, *Carlson v. Kies*, note 1, *supra*, *Smith v. Fuller*, 86 Ohio St. 57, 99 N. E. 214, Ann. Cas. 1913D 387 (1912).

[13] *Boone County Nat. Bank v. Latimer*, 67 Fed 27 (1895).

[14] *In re Stewart*, note (12), *supra*.

[15] *Blake v. State Savings Bank*, note 3, *supra*.

deposits was that of *Carlson v. Kies*,[16] in which the administrator of an estate deposited in a bank money belonging to the heirs, the money to be held until the return of vouchers, at which time the money was to be forwarded to the heirs by bank drafts. In the meantime the bank failed. Our court held that it was a special and not a general deposit inasmuch as the money was to be applied to the specific purpose of being forwarded to the heirs, and that it was no obstacle that the money had been co-mingled with the general funds so that it could not be identified, where an amount equal to or in excess of the deposit remained in the bank until insolvency Relative to this matter of tracing funds the court said:[17]

> "The appellant suggests that the identical money was not traced into the hands of the receiver. That is true, but the old rule requiring an identification of the specific fund or its avails in the hands of a receiver has been relaxed in the later cases. The doctrine of the modern authorities and what we consider the sounder view is that a trust fund is recoverable where an equal amount in cash remained continuously in the bank until its suspension and passed to the receiver."

While it appears that some courts have not followed this doctrine,[18] the Washington court as well as other courts seem to have so done in the later cases.[19]

In *Northwest Lumber Co. v. Scandinavian-American Bank*,[20] the depositor wrote a check on its general account to meet payments of interest on outstanding notes. Although there was sufficient time, the person in charge of the trust department failed to cancel the check and to debit the general account. The court allowed the depositor a priority, saying that the assets passing to the supervisor were augmented by the amount of the check, and thus greater to that extent than would have been the situation had the bank performed its duty and segregated the fund. Apparently this augmentation theory has been followed in a few jurisdictions in order to obviate the difficulty that arises in the requirement of a definite res upon which to predicate a trust, and in the this respect this minority doctrine is possibly open to some criticism.

An attempt was made recently by a depositor to gain a preference

[16] Note 1, *supra*.

[17] On page 176.

[18] *Minard v. Watts*, 186 Fed. 245 (1910) *Fallgatter v. Citizens' Nat. Bank*, note 4, *supra*, *Northern Sugar Corp. v. Thompson*, note 1, *supra*, *Blake v. Brinson*, 286 U. S. 254, 25 S. Ct. 516, 76 L. Ed. 1089 (1932). See 31 Mich. L. Rev 411, and 18 Cornell L. Quarterly 423.

[19] *Central Bank & Trust Co. v. Ritchie*, 120 Wash. 160, 206 Pac. 926 (1922) (to pay a note) *Hitt Fireworks Co. v. Scandinavian-American Bank*, 121 Wash. 261, 209 Pac. 680 (1922) (sum of money then before the parties to be returned intact) *Pacific Building & Loan Assoc. v. Central Bank & Trust Co.*, 127 Wash. 524, 221 Pac. 313 (1923) (bank collected assessments and remitted to depositor less commission.) On the problem of tracing funds, see 77 U. of Pa. L. Rev. 785.

[20] 130 Wash. 33, 225 Pac. 825, 39 A. L. R. 922 (1924).

in a case arising out of the transferring of funds between Canada and the United States.[21] The bank had been required to make an advance to its correspondent of $5,000 for the depositor, to cover fluctuations in the rate of exchange between the two countries. When crediting the depositor's account with $17,931, due from prior transactions, the bank notified them that because of this advancement it would be necessary for them to maintain at least $5,000 in their account during the period the option on Canadian dollars was in effect. The depositor acquiesced in this arrangement and considered that this amount could not be withdrawn. Then the bank became insolvent. The court denied a recovery, ruling that it was no more than a debtor-creditor relationship and that the depositor would have been able to have checked against this $5,000. The dissent stated that the depositor would not have been able to have so checked and that the bank would not have been entitled to use the fund in its general banking business.

It is apparent that the determination of whether the depositor would have been able to have withdrawn this sum was a vital point in the case and should be decided in accordance with general banking practices. There is no doubt but that the deposit was in the bank for the specific purpose of being applied to any loss resulting from a change in the rate of exchange, and that the parties intended it to be so used. The bank, having made the advancement for the benefit of the depositor, would be interested in maintaining some type of security and ordinarily would separate the fund. But this not having been done, the bank would have been justified in refusing to honor checks on the general account below $5,000,[22] or otherwise it could have honored the checks and relied upon the personal credit of the depositor. However, in the face of the stipulation against drawing below $5,000 made by the bank itself, the assumption that it would have been content with the personal credit of the depositor does not seem plausible.

Therefore, if we assume that the fund could not have been withdrawn, the court could have gone the other way in view of the Washington holdings which allow a preference even though the funds are not segregated, where it appears that the parties intended to create a special deposit and that a sum equal to or in excess of the deposit remained in the bank up to insolvency The court declared that if a check for $5,000 had been delivered to the bank, it would have been a different situation, citing in support *Northwest Lumber Co. v. Scandinavian-American Bank;*[23] but in the latter case the delivery of the check was necessary for the establishment of any specific duty on the part of the bank, while in the case under consideration a specific designation had already been made and such delivery would have only made the intention of the parties more clear.

Aside from a consideration of the reasoning employed, the result reached by the case can be justified, as the practical effect of the

[21] *Big West Oil Co. v. Moody*, 79 Wash. Dec. 90, 35 Pac. (2d) 1093 (1934).

[22] *Stephens v. Chehalis Nat. Bank*, 80 Wash. 254, 141 Pac. 340 (1914).

[23] Note 19, *supra.*

agreement was the placing on deposit of $5,000 out of which the defendant bank could have indemnified itself if the correspondent bank had withdrawn some of the $5,000 advanced to it to cover a loss from a change in the rate of exchange. Therefore, if the bank was holding the money for its own benefit there was no trust and consequently no possibility of a preference.[24] If the defendant bank had been holding the money for the purpose of forwarding it to the correspondent bank and thus for the benefit of the correspondent bank, the creation of a trust would have been possible.

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THE TORT LIABILITY OF USERS OF ABANDONED PROPERTY

A question which from the standpoint of decisions is seemingly unique was raised in the case of *Locke v. Pacific Telephone & Telegraph Co. et al*, 78 Wash. Dec. 40, 33 Pac. (2d) 1077 (1934), concerning the liability of users of abandoned property The city of Seattle erected a pole in 1905 on a parking strip bordering one of its streets, for the purpose of carrying the wires of the city's light plant. In 1926 the city removed all of its wires from the pole, and shortly thereafter the defendant telephone company placed a single drop wire on the pole which ran from their main line to the house of a subscriber in front of which the pole stood. This single wire remained on the pole until 1932 when the pole, because of its old and decayed condition, fell across the street and was struck by the plaintiff's auto without any fault on his part. The telephone company was a mere trespasser on the pole, and its drop wire was not a cause of the accident. In an action brought by the plaintiff for personal injuries against the city of Seattle and the telephone company a jury verdict was given in favor of the plaintiff against both defendants, judgment was entered against the city, and a motion for a judgment notwithstanding the verdict was granted in favor of the telephone company Both the plaintiff and the city appeal from the granting of this motion in favor of the telephone company It was held that the defendant telephone company did not have such control over the pole as to create the affirmative duty to inspect and repair running to the public, and that in fact they had no legal right to repair or to remove the pole, and hence were not liable. There is a vigorous dissent by Chief Justice Beals in whose opinion the control exercised by the telephone company was sufficient to create such a duty

It seems conceded that control over the property in question is the basis of the duty to inspect and repair, and the *fact* of the sufficiency of the control exercised in this case is the point upon which the court splits. However, the second reason advanced by the majority for their decision is entirely inconsistent with a mere

[24] Restatement of the Law of Trusts, sec. 111 (5) provides that the sole trustee of a trust cannot be the sole beneficiary of the trust.