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FAILED BANKS, COLLECTION ITEMS, AND TRUST PREFERENCES

By GEORGE GLEASON BOGERT*

ABOUT 1,200 banks failed in the United States during the year 1930,¹ and failures for the years 1921-1929 averaged over 600 a year.² Each of these bank failures doubtless involved several problems regarding collection items. In each case it was almost inevitable that there should be found among the assets in the hands of the defunct bank several items held for collection but not yet collected, and also that a number of items should have been collected but no effective remittance made on account of such collection. There thus arose a series of controversies between the banks or individuals which had forwarded the items for collection and the receivers or other representatives of the general creditors of the failed banks.

The purpose of this paper³ is to trace the trend of the modern

*Professor of Law, University of Chicago.

¹Estimates of Federal Reserve Bank of Chicago.

²Bank failures for the years 1921 to 1929 were as follows: 1921, 501; 1922, 354; 1923, 648; 1924, 776; 1925, 612; 1926, 956; 1927, 662; 1928, 491; 1929, 642; total for the nine years, 5,642. Of these banks 994 were members of the federal reserve system, and 4,648 were non-members. The total capitalization of these failed banks was \$222,823,000. The number having a capital of less than \$25,000 was 2,204; capitalized at \$25,000 were 1,310; \$25,000 to \$50,000, 485; \$50,000 to \$100,000, 985; \$100,000 to \$200,000, 404; \$200,000 to \$500,000, 144; capitalization figures not available, 100. Annual Report, Federal Reserve Board, 1929, pp. 22, 24, 123.

³For other discussion of various aspects of the problem here presented, see Turner, "Deposits of Demand Paper," 37 YALE L. J. 874; Pierson, "Legislation Relating to Problems of Check Collection," 16 AM. B. A. J. 406; Paton, "Uniform Bank Collection Code," AM. BANKERS' A. J., March, 1929, p. 907;

decisions and statutes regarding this struggle for preference, and to advance a theory as to the appropriate placing of the loss in such a case. It is not intended to attempt an analysis or reconciliation of the scores of decisions on preference claims. The authorities are confused, confusing and conflicting. A federal statute for National Banks and a uniform state law, mutually consistent, and founded on a sound economic theory, are much needed.

For the purpose of acquiring a simple set of terms to be used in the subsequent discussion, the following hypothetical case is supposed: D, a depositor in the first bank, deposits with that bank for credit to his checking account and for collection, a check drawn by X in favor of D and upon a second bank. The first bank credits D with the face value of this check, possibly less a small collection charge, and forwards the check to the second bank for collection and remittance. The second bank receives the check and fails, either after it has charged the check to X but before taking any steps to remit to the first bank, or after it has charged the check to X and sent a draft to the first bank for the amount of the check but before the payment of that draft. A controversy then arises between the first bank claiming payment in full of the amount of the check or remittance draft and the receiver of the second bank claiming that the first bank must come in as a general creditor for the amount of the collected check. It is, of course, true that the ordinary collection case is much more complicated than the above hypothetical case in that more than two banks are usually involved, the Federal Reserve or a clearing house system is often implicated, and that special problems sometimes arise out of the form of indorsements and out of agreements regarding methods of credit or remittance; but it is believed that the simple hypothetical case given above will identify the terms "depositor," "first bank" or "forwarding bank," and "second bank" or "collecting bank," and will raise the necessary questions which the more complicated cases would also involve, without producing extraneous difficulties.

THE CASE LAW

An effort will first be made to show the trend of the decisions on

Townsend, "Bank Deposits of Commercial Paper," 7 N. Y. U. L. Q. REV. 293, 618; Townsend, "Constructive Trusts and Bank Collections," 39 YALE L. J. 980; note 68 A. L. R. 725.

the preference question. The cases will be divided into two classes, namely, those decided before 1920 when older methods of clearing and collection were generally in vogue, and those decided since January 1, 1920, when more modern methods have been practiced and when the Federal Reserve system of collections has been in full force and effect.

A search of the decisions prior to 1920 shows that where the item received for collection was either not collected at all, or collected only after the insolvency of the bank holding it for collection, the result has almost always been the return of the collected paper, or a preference to the extent of the collection made after insolvency.⁴

⁴Balbach v. Freylinghuysen, 15 Fed. 675 (depositor against receiver of first bank; check indorsed in blank and immediate credit given); First National Bank v. Armstrong, 42 Fed. 193 (first bank against receiver of second bank; indorsed for collection; collection after insolvency); Beal v. City of Somerville, 50 Fed. 647 (depositor against receiver of first bank; indorsed for deposit; collection after insolvency); Richardson v. New Orleans Coffee Co., 102 Fed. 785 (depositor against first bank; general indorsement; first bank insolvent when paper received); Western German Bank v. Norvell, 134 Fed. 724 (depositor against first bank; indorsed for collection and remittance; paper received when first bank was insolvent); Butler v. Western German Bank, 159 Fed. 116 (first bank against second bank; paper received by second bank when insolvent); Clark Sparks & Sons Mule & Horse Co. v. American National Bank, 230 Fed. 738 (depositor against second bank; received by second bank for collection and remittance and collected when second bank insolvent); In re Jarmulowsky, 249 Fed. 319 (depositor against first bank; indorsed in blank and credit given but not subject to checking; collection after receivership); St. Louis & San Francisco Ry. Co. v. Johnson, 133 U. S. 566 (depositor against first bank; collection after insolvency); Commercial Bank of Pennsylvania v. Armstrong, 148 U. S. 50 (depositor against first bank; indorsed for collection); Lippitt v. Thames Loan & Trust Co., 88 Conn. 185 (first bank against second bank; indorsed for collection and remittance; collection after insolvency); In re State Bank, 56 Minn. 119 (depositor against first bank; unrestricted indorsement); South Park F. & M. Co. v. Chicago G. W. Ry. Co., 75 Minn. 186 (depositor against first bank; unrestricted indorsement; provisional credit received); National Butchers & Drovers Bank v. Hubbell, 117 N. Y. 384 (first bank against second bank; indorsed for collection; collection by receiver of second bank); Scott v. Ocean Bank of New York, 23 N. Y. 289 (depositor against second bank); Jones v. Kilbreth, 49 Ohio St. 401 (depositor against first bank; deposited for collection; collected after insolvency); Alleman v. Sayre, 79 W. Va. 763 (depositor against first bank; collection after failure). In Illinois Trust & Savings Bank v. First National Bank, 15 Fed. 858, there was collection after insolvency and would have been a preference if tracing had been possible.

The second bank has been generally regarded as an agent, bailee, or trustee, holding the paper. Insolvency has been held to revoke the authority of the collecting fiduciary and to make subsequent collection a wrongful act on which a constructive trust could be based. Only in cases of peculiar endorsements or other special conditions has the second bank been regarded as the purchaser or owner of such paper,⁵ and so under no duty to return it after insolvency.

In the numerous cases decided prior to 1920 where the second bank had collected the item before insolvency but had not credited the forwarding bank or remitted to it, there seems to be a slight majority of decisions and jurisdictions against allowing the forwarding bank a preference. Sometimes the reason given for refusing a preference was that no trust or other similar relation with regard to the proceeds was intended.⁶ Sometimes the courts contented them-

⁵*First National Bank v. Armstrong*, 39 Fed. 231 (first bank against second bank; indorsed for collection; credit given; second bank a purchaser); *Cronheim v. Postal Telegraph-Cable Co.*, 10 Ga. App. 716 (depositor against first bank; for collection; collection after insolvency; first bank deemed debtor merely); and see *Hoffman v. First National Bank of Jersey City*, 46 N. J. L. 604, and *Metropolitan National Bank v. Loyd*, 90 N. Y. 530, which were cases of general indorsement and immediate credit and which were decided on a theory which would seem to prevent recovery of the item by the depositor because the first bank had been a purchaser.

As to the meaning of a restrictive indorsement and the powers of such an indorsee, see N. I. L., secs. 36, 37.

⁶*Bank of Commerce v. Russell*, Fed. Cas. 884 (item forwarded for collection and draft sent back but not honored); *Merchants & Farmers Bank v. Austin*, 48 Fed. 25 (for collection and remittance; no attempted remittance); *Anheuser-Busch Brewing Ass'n v. Clayton*, 56 Fed. 759 (for collection and return; remittance draft unpaid); *First National Bank v. Wilmington & W. R. Co.*, 77 Fed. 401 (for collection and remittance; no attempted remittance); *San Francisco Nat. Bank v. American Nat. Bank*, 5 Cal. App. 408 (for collection; no attempted remittance); *Gonyer v. Williams*, 168 Cal. 452 (depositor against first bank; indorsement in blank and credit given); *Lippett v. Thames Loan & Trust Co.*, 88 Conn. 185 (collection and remittance; no attempted remittance); *Citizens Nat. Bk. v. Haynes*, 144 Ga. 490 (for collection and remittance; no attempted remittance); *United States National Bank v. Glanton*, 146 Ga. 786 (for collection; remittance check unpaid); *Union National Bank v. Citizens Bank*, 153 Ind. 44 (for collection and remittance; remittance draft unpaid); *American National Bank v. Owensboro S. B. & T. Co.'s Receiver*, 146 Ky. 194 (for collection); *Young v. Teutonia Bank & Trust Co.*, 134 La. 879 (for collection and remittance; remittance draft unpaid); *Billingsley v. Pollock*, 69 Miss. 759 (for collection; remittance draft unpaid); *Alexander County Nat. Bk. v. Conner*, 110 Miss. 653 (for collection; remittance draft

selves with stressing the fact that, even if a trust was intended, no preference could be given because of the inability to trace the proceeds of the collection.⁷ In a very considerable number of jurisdictions, however, a preference was given to the forwarding bank, usually on a trust theory.⁸

unpaid); *People v. Merchants & Mechanics Bk.*, 78 N. Y. 269 (for collection and remittance; remittance draft unpaid); *People v. City Bank of Rochester*, 93 N. Y. 582 (for collection; credited on mutual account); *National Butchers & Drovers Bank v. Hubbell*, 117 N. Y. 384 (for collection and credit; credited on mutual account); *Corporation Commission v. Bank*, 137 N. C. 697 (for collection); *First National Bank v. Davis*, 114 N. C. 343 (for collection with agreement for daily remittance; no attempted remittance); *Commercial & Farmers Nat. Bk. v. Davis*, 115 N. C. 226 (for collection and remittance; no attempted remittance); *McCormick Harvesting Machine Co. v. Yankton Sav. Bk.*, 15 S. D. 196 (for collection and remittance; remittance to be at intervals; no attempted remittance); *Akin v. Jones*, 93 Tenn. 353 (for collection; remittance draft unpaid); *Sayles v. Cox*, 95 Tenn. 579 (for collection and remittance; no attempted remittance); *Peters Shoe Co. v. Murray*, 31 Tex. Civ. App. 259 (for collection and remittance; draft in remittance unpaid); *Bowman v. First National Bank*, 9 Wash. 614 (for collection and remittance; remittance draft unpaid); *Hallam v. Tillinghast*, 19 Wash. 20 (for collection; no attempted remittance).

⁷*Philadelphia National Bank v. Dowd*, 38 Fed. 172; *Nixon State Bank v. First State Bank*, 180 Ala. 291; *Lummus Cotton Gin Co. v. Walker*, 195 Ala. 552; *J. Allen Smith Co. v. Montgomery*, 95 So. 290; *Ober & Sons Co. v. Cochran*, 118 Ga. 396; *In re Seven Corners Bank*, 58 Minn. 5; *Midland National Bank v. Brightwell*, 148 Mo. 358; *Frank v. Bingham*, 58 Hun. (N. Y.) 580; *White v. Bank*, 60 S. C. 122; *Nonotuck Silk Co. v. Flanders*, 87 Wis. 237.

⁸*First National Bank v. Armstrong*, 36 Fed. 59 (collecting bank earmarked part of its cash as representing collection); *Boone County National Bank v. Latimer*, 67 Fed. 27 (for collection and remittance; cash proceeds of collection mingled with other cash and balance of cash exceeded amount of collection); *Holder v. Western German Bank*, 132 Fed. 187 (for collection and remittance by New York exchange; no attempted remittance), see also 136 Fed. 90; *American Can Company v. Williams*, 178 Fed. 420 (for collection); *Titlow v. McCormick*, 236 Fed. 209 (for collection; proceeds traced into credit of collector at another bank); *State National Bank v. First National Bank*, 124 Ark. 531 (for collection; collector received no benefit except cancellation of its debt to a depositor); *Henderson v. O'Connor*, 106 Cal. 385 (for collection; collector had received benefit in form of increased credit in another bank); *First National Bank v. Hummel*, 14 Colo. 259 (for collection and remittance; cash collection proceeds mixed with other cash and no remittance); *National Life Ins. Co. v. Mather*, 118 Ill. App. 491 (for collection and remittance; no attempted remittance); *Nurse v. Satterlee*, 81 Iowa 491 (for collection; preference although collector had credited depositor on its books); *Kansas State Bank v. First National State Bank*, 62 Kan. 788 (for collection and remittance; seems to be decided on the exploded "swelling of assets" the-

The decisions since 1920 with regard to uncollected paper, or paper collected after insolvency, are generally in favor of its return to, or a preference for, the forwarding bank,⁹ although occasionally the form of endorsement has been held to make the second bank a purchaser, subject to no duty to return.¹⁰

In the decisions of the last ten years regarding items collected by the failed bank but not credited or remitted for prior to insolvency, there seems to be an increasing tendency to allow a prefer-

ory); *Sherwood v. Central Michigan Savings Bank*, 103 Mich. 109 (for collection and notification; improper credit to depositor on books); *Wallace v. Stone*, 107 Mich. 190 (for collection and remittance; no attempted remittance); *Ryan v. Paine*, 66 Miss. 678 (for collection and remittance; attempted remittance unsuccessful); *German Fire Ins. Co. v. Kimble*, 66 Mo. App. 370 (for collection and remittance; attempted remittance ineffective); *Guignon v. First National Bank*, 22 Mont. 140 (to credit and notify; collecting bank had received credit to amount of collection); *Anheuser-Busch Brewing Ass'n v. Morris*, 36 Neb. 31 (form of indorsement not given); *Griffin v. Chase*, 36 Neb. 328 (for collection and remittance; tracing not discussed); *Thompson v. Gloucester City Savings Inst.*, 8 Atl. 97 (for collection; no strict tracing rules followed); *First National Bank v. Dennis*, 20 N. M. 96 (for collection and remittance; no attempted remittance); *Arnot v. Bingham*, 55 Hun (N. Y.) 553 (for collection; collecting bank received and cancelled check on itself in collecting); *Warren-Scharf Paving Co. v. Dunn*, 8 App. Div. (N. Y.) 205 (for collection; proceeds traced into chose in favor of collector); *Blair v. Hill*, 50 App. Div. (N. Y.) 33 (for collection and remittance; attempted remittance unsuccessful); *Mad River National Bank v. Melhorn*, 8 Ohio Cir. Ct. 191 (1894) (for collection and remittance; attempted remittance ineffective); *Plano Mfg. Co. v. Auld*, 14 S. D. 512 (for collection; no credit or remittance); *Bank of Sherman v. Weiss*, 67 Tex. 331 (for collection; no attempted remittance); *Continental National Bank v. Weems*, 69 Tex. 489 (for collection and return of proceeds intact); *Hunt v. Townsend*, 26 S.W. 310 (for collection and remittance; no attempted remittance); *First National Bank v. Union Trust Co.*, 155 S.W. 989 (for collection and remittance; no attempted remittance); *Foster v. Rincker*, 35 Pac. 470 (for collection; remittance attempted).

⁹In all the following cases the bank received the paper for collection after its officers knew it was insolvent: *Federal Reserve Bank v. Idaho Grimm Alfalfa Seed Grain Ass'n*, 8 F.(2d) 922; *Marvin v. Martin*, 20 F.(2d) 746; *Hollway v. Dykes*, 29 F.(2d) 430; *Ellerbe v. Studebaker Corp. of America*, 21 F.(2d) 993. In *Salem Elevator Works v. Commissioner of Banks*, 252 Mass. 366, a collection after insolvency would have resulted in a preference, if tracing could have been made out.

¹⁰In the following cases a general indorsement and immediate credit, although subject to cancellation, made the transaction a purchase of the paper: *Bryant v. Williams*, 16 F.(2d) 159; *Ashley State Bank v. City National Bank*, 32 F.(2d) 166.

ence to the forwarding bank, even without the aid of a statute,¹¹ but

¹¹*Spokane & Eastern Trust Co. v. U. S. Steel Products Co.*, 290 Fed. 884 (for collection and return; attempted remittance ineffective); *Bank of Metropolis v. First National Bank*, 19 F.(2d) 301 (for collection; collection but no remittance or credit); *Peoples National Bank v. Moore*, 25 F.(2d) 599 (for collection and remittance; attempted remittance); *Monticello Hardware Co. v. Weston*, 28 F.(2d) 672 (for collection; attempted remittance); *Washington Loan & Banking Co. v. Fourth Nat. Bank*, 38 F.(2d) 772 (for collection and credit; collecting bank had received credit for item); *Hanover National Bank v. Thomas*, 117 So. 42 (for collection and credit); *Rainwater v. Federal Reserve Bank*, 172 Ark. 631 (for collection and remittance; attempted remittance ineffective); *Atlantic National Bank v. Pratt*, 116 So. 635 (for collection and remittance; attempted remittance); *Tunncliffe v. City National Bank & Trust Co.*, 118 So. 319 (like next preceding case); *Edwards v. Lewis*, 124 So. 746 (for collection and remittance; attempted remittance ineffective); *Skinner v. Porter*, 45 Idaho 530 (for collection and remittance; attempted remittance ineffective); *Krueger v. First National Bank*, 217 Ill. App. 18, (dictum); *People v. Iuka State Bank*, 229 Ill. 4 (for collection and return; no remittance attempted); *Murray v. North Liberty Savings Bank*, 196 Iowa 729 (for collection and remittance; credit given); *Leach v. Iowa State Savings Bank*, 212 N. W. 748, rehearing 215 N.W. 728 (to collect interest on mortgages and remit); *Andrew v. State Bank of Dexter*, 215 N.W. 742 (for collection; no remittance attempted); *Goodyear Tire & Rubber Co. v. Hanover State Bank*, 109 Kan. 772 (for collection and remittance; attempted remittance ineffective); *Kesl v. Hanover State Bank*, 109 Kan. 776 (for collection and remittance; attempted remittance ineffective); *Griffith v. Burlington State Bank*, 277 Pac. 42 (for collection and return; attempted remittance ineffective); *Sabine Canal Co. v. Crowley Trust & Savings Bank*, 164 La. 33 (for collection and remittance; attempted remittance ineffective); *Eifel v. Veigel*, 169 Minn. 281 (for collection; no remittance); *Emerson v. Veigel*, 176 Minn. 584 (to collect price of land; unauthorized credit to forwarder); *Bauk v. Beigel*, 225 N.W. 916 (for collection; remittance ineffective); *National Shawmut Bank v. Barnwell*, 140 Miss. 816 (for collection and credit; forwarder insolvent before credit given); *Federal Reserve Bank v. Millspaugh*, 282 S.W. 706 (for collection and remittance by currency or draft; draft remittance not honored); *Bank of Poplar Bluff v. Millspaugh*, 313 Mo. 412 (to collect and credit); *Federal Reserve Bank v. Quigley*, 284 S.W. 164 (for collection and remittance; attempted remittance ineffective); *State v. Banking Corporation of Montana*, 77 Mont. 134 (for collection); *Hawaiian Pineapple Co. v. Browne*, 69 Mont. 140 (for collection and remittance; remittance draft not honored); *State v. Banking Corporation of Montana*, 74 Mont. 491 (for collection and credit); *McDonald v. American Bank & Trust Co.*, 255 Pac. 733 (for collection and notification; no notification or credit); *Sinclair Refining Co. v. Tierney*, 270 Pac. 792 (for collection and remittance; remittance draft never paid); *Matter of Bank of Cuba*, 198 App. Div. (N. Y.) 733 (for collection and remittance; no remittance attempted); *Blair v. Union Savings Bank*, 162 N.E. 423 (for collection; remittance ineffective); *Thomas v. Mothersead*, 128 Okla. 157 (for collection and remittance; remittance draft not honored); *First State Bank*

the decisions are quite evenly divided.¹²

v. O'Bannon, 266 Pac. 472 (for collection and remittance; remittance draft not honored); State v. Excello Feed Milling Co., 131 Okla. 100 (for collection and remittance; remittance draft not honored); Yeldell v. Peoples Bank, 110 S.E. 789 (for collection and remittance); Schimke v. Smith, 211 N.W. 461 (for collection and remittance in specie); Federal Reserve Bank v. Peters, 139 Va. 45 (for collection and remittance; remittance draft not honored); Central Trust Co. v. Mullens, 150 S.E. 137 (for collection and remittance; remittance draft not honored); Central Trust Co. v. Mullens, 153 S.E. 145 (same as next preceding case; based on equitable assignment theory); Vermont Loan & Trust Co. v. First National Bank, 260 Pac. 534 (for collection and remittance; remittance draft not paid); Lusk Development and Imp. Co. v. Gjinther, 32 Wyo. 294 (to collect price of land; draft not paid).

¹²In the following cases there was no preference granted because of a lack of intent to have a trust of the proceeds of the collection: Bishop v. United States, 16 F.(2d) 406; Dickson v. First National Bank, 26 F.(2d) 411; Wrightsville & T. R. Co. v. Citizens & S. National Bank, 36 F.(2d) 736; Equitable Trust Co. v. Rochling, 48 Sup. Ct. 58 (for account of another then forwarder; credit established); Latzko v. Equitable Trust Co., 48 Sup. Ct. 60; City of Douglas v. Federal Reserve Bank, 46 Sup. Ct. 554 (*semble*); Farmers & Merchants Bank v. State, 23 S.W.(2d) 624; Head v. Mobley, 152 S.E. 473; Leach v. Citizens State Bank, 211 N.W. 522 (for collection and remittance; attempted remittance failed); Leach v. Battle Creek Savings Bank, 202 Iowa 871 (for collection and credit; no credit made); Leach v. Iowa State Bank, 202 Iowa 875 (for collection and remittance; attempted remittance ineffective); Colorado & S. Ry. v. Docking, 124 Kan. 48 (for collection and remittance; attempted remittance ineffective); Massey-Harris Harvester Co. v. First State Bank, 122 Kan. 483 (for collection; attempted settlement ineffective); Lawrence v. Lincoln County Trust Co., 125 Me. 150 (for collection and credit; credit accomplished); Central Trust Co. v. Hanover Trust Co., 242 Mass. 265 (for collection and remittance; attempted remittance ineffective); Hecker-Jones-Jewell Milling Co. v. Cosmopolitan Trust Co., 242 Mass. 181 (for collection and remittance; no attempted remittance); Love v. Federal Land Bank, 127 So. 720 (for collection and remittance; attempted remittance ineffective); May v. Bank of Hughesville, 291 S.W. 170 (for deposit and credit; credit given); California Packing Corp. v. McClintock, 75 Mont. 72 (for collection and remittance; attempted remittance ineffective); State v. McKinley County Bank, 252 Pac. 980 (for collection and remittance; attempted remittance ineffective); North Carolina Corp. Com'n v. Bank of Hamley, 135 S.E. 342 (for collection only; attempted remittance ineffective); Citizens Bank of Pinewood v. Bradley, 134 S.E. 510 (for collection and remittance; attempted remittance ineffective); Fant v. Dinkins, 149 S.C. 363 (for collection; attempted remittance ineffective); Ryer Grain Co. v. American Security Bank, 147 Wash. 42 (for collection and remittance; attempted remittance ineffective); Citizens State Bank v. Spokane & Eastern Trust Co., 143 Wash. 9 (for collection and return).

In the following cases the emphasis in refusing a preference was on inability to trace: Nyssa-Arcadia Drainage Dist. v. First National Bank, 3 F.(2d) 648; Larabee Flour Mills v. First National Bank, 13 F.(2d) 330;

COLLECTION PRACTICE

A great deal might be said with regard to the collection system in vogue in this country before the inauguration of the Federal Reserve system and thereafter.¹³ Undoubtedly prior to 1913 the collection system was based on decentralized reserves, was greatly lacking in uniformity, did not generally involve the practice of direct routing, and was founded partly on an attempt by forwarding banks to avoid the payment of collection fees. Under the Federal Reserve system, the Federal Reserve banks and Federal Reserve board have, of course, been used to a very large extent as clearing houses for all member and some non-member banks. The city clearing houses have handled local items to an increasing extent. There has remained, however, a large group of miscellaneous collection items handled in a variety of ways. Direct routing is becoming an approved practice.¹⁴ In some cases credit and debit for collection items have

Farmers National Bank v. Pribble, 15 F.(2d) 175; Smith Reduction Corp. v. Williams, 15 F.(2d) 874; First National Bank v. Williams, 15 F.(2d) 585; Rorebeck v. Benedict Flour & Feed Co., 25 F.(2d) 440; Burnes National Bank v. Spurway, 28 F.(2d) 40; Steele Briggs Seed Co. v. Spurway, 28 F.(2d) 42; Early & Daniel Co. v. Pearson, 36 F.(2d) 732; Rainwater v. Wildman, 172 Ark. 521; National Bank of the Republic v. Porter, 258 Pac. 544; Andrew v. Darrow Trust & Savings Bank, 217 N.W. 438; Andrew v. Hamilton County State Bank, 223 N.W. 176; State v. Citizens Bank, 220 N.W. 593; Hall v. Sullivan, 123 Okla. 233; Northwestern National Bank v. James Valley Bank, 221 N.W. 82; Farmers State Bank v. Smith, 222 N.W. 143.

¹³KNIFFIN, *COMMERCIAL BANKING*, Ch. XIII; WESTERFIELD, *BANKING PRINCIPLES AND PRACTICE*, Ch. XVI and XVII; LANGSTON, *BANKING PRACTICE*, p. 162; SPAHR, *THE CLEARING AND COLLECTION OF CHECKS*, Ch. III, IV, VI, X, XIII; WILLIS AND STEINER, *FEDERAL RESERVE BANKING PRACTICE*, p. 598.

¹⁴For the older view that direct routing was improper, see *National Reserve Bank v. National Bank of the Republic*, 172 N. Y. 102. The American Bankers' Association prepared a short statute to permit forwarding paper direct to the payor, and this has been adopted in a number of states without modification. Ala. Code 1923, sec. 9222; Ga. Code 1926 Annotated sec. 2366 (182); Idaho L. 1925, c. 133, sec. 93; Ill. Rev. Stat. 1925, c. 98, sec. 95; Me. L. 1923, c. 150, sec. 4; Mich. L. 1919, No. 386; Nev. L. 1919, c. 127, p. 242; N. C. L. 1921, c. 4, sec. 39; Ohio Gen. Code 1921, sec. 710-133; S. D. L. 1919, c. 117; Utah L. 1925, c. 3. And in others in modified form. Miss. L. 1926, c. 246; Or. Supp. 1927, p. 1381; Va. L. 1928, c. 507; W. Va. L. 1925, c. 32; Wyo. L. 1927, c. 100, sec. 47. Some other states have similar legislation. Ark. Acts of 1921, Act 496, sec. 14; Cal. L. 1925, c. 312, sec. 5; Minn. L. 1927, c. 138; Mont. L. 1927, c. 89, sec. 89; N. D. L. 1927, c. 92. The American Bankers Association Collection Code (sec. 6) expressly authorizes direct routing and is

been given before collection, subject to cancellation; while in other cases no debit or credit has been made until collection.

The only really vital element in the banking practice regarding collections so far as this paper is concerned would seem to be the practice regarding the disposal of the proceeds of the collection and regarding the method of credit or remittance by the collecting bank. That practice, both before 1913 and since, in almost all cases, has undoubtedly been based upon (1) a privilege in the collector to dispose of the proceeds of the collection in any way he pleased, and (2) upon a duty to remit to or credit the forwarder by effecting an increase in the forwarder's credit out of any of the collector's property.

The collector has usually received the benefit of the collection by charging the account of one of its depositors and thus reducing one of its (the collector's) debts, or by receiving cash which it was at once at liberty to use as its own absolute property, or by receiving a check or draft on a third party which the collector was at liberty to use, and did use, to pay its debts to others or to establish credit for itself elsewhere. There has been no duty or custom to convert the exact proceeds of the collection (if any proceeds could be found) into a credit or paper in favor of the forwarding bank.

The credit or remittance to the forwarding bank, intended to compensate it and make it whole, has been generally accomplished either by a mere bookkeeping entry in favor of the forwarding bank on a joint account between forwarding and collecting bank, or by a similar entry in favor of a correspondent of the forwarding bank, or by sending the forwarding bank a check or draft which it could use to establish credit for itself. In very few cases has there been any requirement or custom that the source of the credit passed on to the forwarding bank should be the benefit received by the collecting bank as a result of the collection. Contract and custom have permitted that source to be any of the assets of the collecting bank.

Many cases make a distinction between "for collection and credit" and "for collection and remittance," giving a preference in the lat-

in force in eleven states. See footnotes 25 and 26, *post*. The proposed Uniform Bank Collection Code of the Commissioners on Uniform Laws (sec. 41) authorizes direct routing, as does also Regulation J of the Federal Reserve Board regarding Clearing and Collection. See also Comp. L. Fla. 1927, sec. 6834, to the same effect.

ter case but not in the former. To the writer this seems an illogical distinction. In both cases the collector can do what he likes with the proceeds of the collection. In both cases he can pay the forwarder out of any assets. Until credit or remittance, there is a debt from collector to forwarder and no effort to pay it. After credit and before payment there is a mere bookkeeping note of the debt, but no step to pay. After attempted remittance but before collection of the remittance paper, there is a mere debt with steps taken by the debtor to effect payment, but still no payment. A creditor almost paid ought to be no better off than any other creditor.

RECENT STATUTORY CHANGES

In the past few years eighteen state legislatures have enacted statutes creating preferences against failed banks in collection cases.

In 1919 the Georgia legislature¹⁵ provided for a "lien" on all the assets of the failed bank where an item had been sent for collection and remittance, collection had occurred and no remittance had been made, or the remittance was ineffective.

In 1925 Colorado by statute¹⁶ gave a preference to the first or forwarding bank against the second or collecting bank, where the latter had collected and issued a draft in remittance which was not paid.

In 1926 Louisiana adopted an act¹⁷ giving the depositor a preference against his bank when it had received the benefit of a collection item and failed without having credited the depositor. This statute also gave a preference to the first or forwarding bank against the second or collecting bank when the second had collected and issued a check or draft by way of remittance but the check or draft proved ineffective, due to the failure of the collecting bank.

North Carolina in 1927 enacted a statute¹⁸ giving a lien on the assets of a failed collecting bank, where the item was sent for collection and remittance, collection was made, but there was no attempt at remittance or the paper sent in remittance was never paid.

¹⁵Ga. Ann. Code 1926, sec. 2366.

¹⁶Colo. L. 1925, c. 63.

¹⁷La. L. 1926, no. 63.

¹⁸C. 113, L. 1927; see N. C. Banking Law, c. 113, sec. 1 (14); and discussion in 6 N. C. L. Rev. 174.

In 1927 South Carolina adopted an act¹⁹ giving a preference to the first bank against the second bank in all cases, both before and after collection. This statute has since been superseded by the American Bankers' Association Code referred to later.²⁰

In 1927 Utah passed a law²¹ giving a preference to the first bank against the second bank when paper has been received by the second bank for collection and remittance or payment, the paper has been collected and an ineffectual attempt has been made to remit by check, draft, or an authorization to a correspondent to charge an account.

In 1929 the Iowa legislature²² created a preference by statute in favor of the holder of any draft or cashier's check issued against actual existing values by any bank prior to its failure and given in payment of clearings.

In 1929 a Wyoming statute²³ was adopted giving a preference in favor of the holder of checks, drafts, or other instruments issued in payment of collection items.

In 1929 The American Bankers' Association adopted²⁴ and urged upon the state legislatures a collection code which was enacted by nine states in that year²⁵ and by two states in 1930.²⁶ The principal provisions of this code insofar as the subject of this article is concerned, are as follows: banks holding paper for collection are deemed to be agents of the depositor or forwarder; a bank failing with collected paper in its hands is under a duty to return the paper to the party from whom it received the paper; if the second bank is the drawee or payor bank, and has collected the item by charging its customer's account but does not settle in money or in unconditional credit on its books or the books of another bank, and fails, a preference against all the assets of the failed bank on a trust the-

¹⁹S. C. Acts 1927, no. 202.

²⁰See footnote 25, post.

²¹Utah L. 1927, c. 49.

²²Iowa L. 1929, c. 30, sec. 11.

²³Wyo. L. 1929, c. 141, secs. 1-3.

²⁴See Paton, *AM. BANKERS' A. J.*, March 1929, p. 207, and 46 *BANKING L. J.* 508; and 43 *HARV. L. REV.* 307.

²⁵Ind. L. 1929, c. 164; Mo. L. 1929, p. 205; Neb. L. 1929, c. 41; N. M. L. 1929, c. 138; N. Y. L. 1929, c. 589; Wash. L. 1929, c. 203; Md. L. 1929, c. 454; N. J. L. 1929, c. 270; Wis. L. 1929, c. 354.

²⁶Ky. Acts 1930, c. 13; S. C. Acts 1930, no. 822.

ory is given in favor of the forwarder of the item; if the second bank is not a drawee or payor bank but collects and does not remit by money or unconditional credit established in favor of the forwarding bank, and fails, there is a preference against all the assets of the collecting bank on a trust theory in favor of the owner of the item. No tracing or identification of proceeds is required.

For the past two years the National Conference of Commissioners on Uniform State Laws has been engaged in drawing a collection code covering the subject in question, the draftsman of the code being Professor Turner of Yale.²⁷ Two drafts of this code have now been considered by the Conference and final approval of the code at the 1931 meeting is a possibility. This proposed uniform code makes an effort to establish the first bank as a purchaser of the paper in nearly all cases and the second bank as an agent.²⁸ It contains no provision regarding uncollected paper. It gives a preference out of all the assets of the failed collecting bank except fixed assets, where the collecting bank has received an item for remittance, has obtained the benefit of the collection by charging its customer's account or otherwise, and has not remitted. The preference is based on a trust theory and runs in favor of prior parties as their interests may appear,²⁹ without any requirement of tracing or identification.

Another effort on the part of the American Bankers' Association affecting the question under discussion should be noticed. Counsel for that Association have prepared a uniform deposit slip agreement to be printed on each deposit ticket for the purpose of binding depositors to certain conditions.³⁰ The principal features of this uniform agreement are that items received for deposit or collection are received as agent, that credit given the customer is subject to final payment of the item, that the receiving bank is under no liability for the acts of correspondents or for losses in transit, that direct forwarding is allowed, that the collecting bank may remit by its draft or credit in lieu of cash, and that the receiving bank may charge

²⁷Handbook, Conference of Commissioners on Uniform State Laws, 1929, 136, 249; Handbook, Conference of Commissioners on Uniform State Laws, 1930, pp. 148, 304.

²⁸Secs. 22-28, 1930 draft.

²⁹Sec. 32, 1930 draft.

³⁰1 PATON'S DIGEST OF BANKING LAW, par. 1446.

back the item before final payment. According to the view of counsel for the Association, a large proportion of the banks of the country have adopted substantially this form.³¹ An examination of a limited number of deposit slips seems to confirm this estimate of Mr. Paton.³² The principal present importance of this uniform deposit slip agreement would seem to be that it tends to confirm the general understanding that there is a privilege on the part of the collecting bank to remit out of any of its assets and thus contradicts the notion of a strict trust as to the proceeds of the collection.

An unsuccessful effort was made by Representative Strong of Kansas to secure the adoption by Congress about a year ago of a preference statute affecting national banks which have collected items.³³ It sought to give a preference out of all the assets on a preferred-debt theory, but only in the case where the item was connected with a document of title affecting real or personal property.

A study of the decisions, statutes, and proposed statutes referred to above will show, it is believed, a rather striking tendency to give a preference to the depositor or forwarder of the collection item at the expense of the general creditors of the failed bank. The next question to be considered is whether this preference can be justified on legal or economic theories.

IS THE PREFERENCE REASONABLE ON THE BASIS OF THE INTENT OF THE PARTIES?

It would be possible to justify a preference in favor of the forwarder of the collection item on a theory of the intent of the depositor, forwarder and collector, if such intent were actually expressed and were sought to be accomplished in a legal manner. The parties could, for example, express an intent that the proceeds of the collection in the form of coins, bills, commercial paper, or credit should

³¹Private letter from Thomas B. Paton, Jr., assistant General Counsel, American Bankers' Association.

³²By the kindness of the writer's students and other friends, he was able to collect deposit slips from 34 banks. Of these 27 had printed conditions upon them similar to the bankers' standard form. Thirteen of these were from Chicago, five from Minnesota, eight from Indiana, and one from Massachusetts. Seven others had no printed conditions upon them. In this latter group were five from Chicago, one from Minnesota, and one from Massachusetts.

³³H. R. 5634, introduced Dec. 2, 1929, and referred to the Committee on Banking and Currency.

be held in strict trust and that such proceeds, or their successors, should be remitted to the forwarder or depositor. As previously stated, however, it seems impossible to find any such trust intent. Custom, the deposit slips, and the transit letters accompanying the paper show that the parties actually intend a remittance by means of increasing the forwarder's credit out of any of the collector's assets. The trust institution has long been based on the theory of the necessity of a specific equitable interest in a specific thing as a basis for its existence.³⁴ To establish a rule by decision or statute that a trust can exist without definite subject-matter, or to create fictions about subject-matter and state that it exists where in fact it does not, is vicious in that it makes the law uncertain and contradictory. The collection problem can be solved without recognizing a trust without a res, and thus injuring the integrity of the trust institution.

Even if the parties actually intended a trust of the collection proceeds, there could usually be no preference if strict principles of tracing were followed. The collecting bank commonly receives the benefit of the collection by the cancellation of one of its debts to a depositor or to a correspondent. The cancellation of a debt leaves no property interest which can be a trust subject-matter. The result of the cancellation of a debt is purely negative.³⁵

The preceding paragraphs regarding a possible trust-intent theory for preference have been based on the idea of an express trust. It may be urged that a constructive trust would be a satisfactory basis for giving the preference. Such a trust would not, of course, be established on the intent of the parties but rather on an inequitable holding by the collecting bank of a specific interest in a specific thing.³⁶ Here again the lack of any specific coins, bills, commercial paper, or credit inequitably obtained or held by the collecting bank as a result of the collection is, in the great majority of cases, obvious. The parties do not intend that the collector shall make any particular disposition of the proceeds of the collection or satisfy its

³⁴Burke v. Burke, 259 Ill. 262; Gough v. Satterlee, 32 App. Div. (N. Y.) 33, 40.

³⁵Mechanics & Metals Nat. Bk. v. Buchanan, 12 F.(2d) 891; Steele Briggs Seed Co. v. Spurway, 28 F.(2d) 42.

³⁶Maltbie v. Olds, 88 Conn. 633; Miller v. Miller, 266 Ill. 522.

duty to the forwarder out of any particular source. A constructive trust requires definite subject-matter just as much as an express trust.

It may be urged that a preference could be given on an equitable lien theory, based on the intention of the parties. Equitable liens are rather vague interests which sometimes purport to be founded on an actual intent of the parties to have an equitable lien, sometimes on a frustrated intent to have a legal lien, and sometimes on more vague general equities.³⁷ Insofar as it is sought to give a preference to the forwarding bank on a theory that the parties intended part or all of the assets of the collecting bank to be subject to a lien in favor of the forwarding bank, the position seems untenable because of the failure of the parties to manifest any such desire. By all their written and spoken words, and by all their other conduct and customs, they clearly manifest an intent to have all the assets of the collector free of any lien or in rem claim in favor of the forwarder, and to have the benefit of the collection flow back to the forwarder out of any of the assets of the collector.

It may be urged that a preference could be awarded on the basis of an equitable assignment, where the collecting bank has attempted to remit by check or draft, but the check or draft is dishonored on account of the failure of the collecting bank. Prior to the adoption of the Negotiable Instruments Law there was a minority view that a check or draft could of itself constitute an assignment of a part of the chose in action against the payor or drawee.³⁸ These early views may have influenced some of the early collection item cases, but, since the universal adoption of the Negotiable Instruments Law, it has usually been clear that the mere making and delivery of a check or draft does not constitute a partial assignment of the chose in action on which it is drawn.³⁹ In actuality the collector remitting

³⁷For examples of equitable liens based on actual intent, see *In re Farmers Supply Co.*, 170 Fed. 502; *Westall v. Wood*, 212 Mass. 540. For cases where there was no expressed or implied intent for security but chancery regarded it as equitable that certain property of the debtor should stand as security, see *Kline v. Cofield*, 159 Ky. 744; *Elterman v. Hyman*, 192 N. Y. 113; *Town of Covington v. Hayden*, 27 F.(2d) 360. For a good discussion of equitable liens see, Britton, "Equitable Liens," 8 N. C. L. Rev. 388.

³⁸For some citations see 37 YALE L. J. 626; Brannon, *Neg. Inst. Law Ann.* (3d ed.), pp. 356, 403; 5 U. L. A. 708; 5 C. J. 917, 919.

³⁹N. I. L., sec. 127, 189.

by check or draft never contemplates making the forwarder part-owner of a chose in action against the payor or drawee of the check or draft. It intends to give the forwarder power to acquire cash or credit by the use of the check or draft on presentation of it to the payor or drawee bank. It is believed that the exceedingly cumbersome result of temporary co-ownership of a chose in action is in reality never contemplated or desired.

It would be obviously impossible to justify the preference for the forwarding bank on the basis of intent of the parties if the preferred-debt concept were used. Preferred debts are with rare exceptions based on statutes, and not on the carrying out of the intentions of creditors and debtors.

WHAT SOLUTION IS PREFERABLE ON THE BASIS OF ECONOMIC POLICY?

If it be conceded that the parties to the collection transaction have not themselves established a preference or placed the risk of loss by virtue of a properly expressed intention, there remains the question whether there are economic reasons for granting a preference or fixing the loss on a particular party by means of a statute. From the view-point of commercial expediency and policy, upon whom should a statute cast the losses occurring through the failure of collecting banks after collection but before credit or remittance? Does the placing of the loss in the most practical and expedient manner involve the use of a preference against the failed bank?

These losses might, if one were starting *de novo* to frame a code, be placed upon any one of several individuals or groups, namely:

- (a) upon the forwarder of the item for collection;
- (b) upon the original depositor of the item for collection;
- (c) upon the debtor who sought to pay his debt by use of the item which was forwarded for collection;
- (d) upon the general creditors of the failed collecting bank;
- (e) jointly upon the two parties who sought to pay and collect a debt by the use of the item collected;
- (f) upon the whole commercial-paper-using class of the country, or of a certain section of the country, who get the benefit of the clearing and collection system.

These suggestions will be taken up for comment in order.

(a) If the loss were thrown on the forwarding bank, unless prohibited by statute, the forwarding bank would pass the loss back to the depositor of the item, as it generally does now, by means of an agreement forced upon such depositor. Or if prevented from shifting the loss in this way, the forwarding bank would transfer the loss to those using its collection facilities by making larger charges for collection. This process would also enable the bank to protect itself against future losses by some form of insurance. The forwarding bank would not permanently bear the loss. It would ultimately fall on the individual depositor for collection, or on the depositors of that bank as a class. The latter result would make collecting more expensive, and would hence slightly obstruct the use of commercial paper as an equivalent of currency.

The Federal Reserve banks protect themselves against liability arising out of the failure of collecting banks by express provision in their notices to member and non-member clearing banks.⁴⁰

It would seem unjust and inexpedient to place any final or ultimate liability on any bank taking part in the collecting process. The collection system of the country is one in which the banks are mere conduits, or media, for transmitting credit to or from the debtor classes and from or to the creditor classes. The banks are either paid nothing directly for performing this service, or are paid small sums which are merely sufficient to cover part of the postage, book-keeping and clerical expenses. Obviously the banks do receive benefits from the maintenance of checking accounts in that they thereby secure means for lending money at a profit, and it may be urged that the banks do receive in this way sufficient indirect benefits to make it just that they should assume the risk of the failure of their correspondents who are collecting items.

The banks can not reasonably be expected to collect in cash or to keep separate paper or credit received as the proceeds of collections. Such separation would involve an enormous amount of labor and bookkeeping which would impede business and require much greater collection charges.

(b) If the loss is by statute put on the depositor of the item for collection, he will shift the burden in his future contracts. He

⁴⁰See Bulletin 213, Federal Reserve Bank of Chicago, Sept. 2, 1930.

will compel his debtors to agree in advance that payment by paper shall be subject to collection in full,—that payment shall not be complete until the paper is collected and its proceeds transmitted to the creditor. This procedure is to some extent followed at present. Or the depositor, and others of his class, will charge slightly more for their goods or services so as to insure against collection risks.

(c) Much can be said for the position that a debtor does not pay his debt by the use of commercial paper until the proceeds of that paper reach his creditor. A Montana statute⁴¹ has taken a position of this type. It is an accommodation to the debtor to be allowed to pay by check or draft, instead of by currency. If he had to bear this risk initially, he could not shift it. He would not be strong enough to compel a reduction by the creditor in the price of his goods or services, to offset the debtor's risk.

(d) It is no doubt easiest to throw the loss on the general creditors of the failed bank. Most failed banks are small institutions, in the country or in small cities. Their general creditors have individually relatively small claims. As a class they are not nearly as influential with the legislatures as the forwarding city banks or the city creditors. Before courts these general creditors are not present personally, but are represented by a receiver who is not always especially interested in them. Perhaps the feeling is that they have to lose anyway, and that it is not very material whether they lose a little more or less. But it seems unjust to throw this burden on these general creditors. They were not connected with this collection transaction as beneficiaries in any way. They constitute only a small portion of the beneficiaries of the whole country-wide system of collections.

Those who seek to justify a preference in favor of the depositor of the item as against the general creditors of the failed bank advance certain arguments based on a higher or superior equity in favor of the depositor. They say that the depositor of the item for collection is a distant, involuntary, temporary creditor with no chance to investigate the character of the bank in question; whereas the gen-

⁴¹A recent act in Montana (sec. 6108, Rev. Codes; L. 1925, c. 65) seems to throw the loss through failure of a collection remittance on the debtor who issued the paper sought to be collected. He remains liable on his debt, just as if he had not issued paper to pay it, at least in certain cases.

eral creditors of the failed bank are to a large extent located near the failed bank, voluntarily enter into the debtor-creditor relationship, are more or less permanent, long-time creditors, and have an opportunity to investigate the character of the bank in question. Since the contending claims of the depositor of the paper and general creditors of the failed bank are under the present assumption not equitable in type, these arguments would not seem to be sufficient to move a court or to justify a judicial decision. Any weight they may have should affect legislation only. To the writer it seems that they ought to have little weight in framing statute law. Both the depositor of the paper and the general creditors of the forwarding bank have seen fit to rely on the common debtor-creditor relationship.

Preferred debts are usually created by statute in the administration of the estates of deceased persons, insolvents, and the like, for one of four reasons, namely: (1) to care for the expenses of the administration of the estate; (2) to satisfy governmental claims; (3) to pay persons who have rendered particularly meritorious services or have particularly meritorious claims, as in the case of funeral expenses, expenses of the last illness, or claims of a widow or children; and (4) to secure payment to those in a low economic position as, for example, laborers, household servants and the like. It would not seem that the depositor of the item for collection deserves preference on any of these grounds.⁴²

⁴²For examples of statutory preferment of claims against insolvent banks, see Carroll's Ky. Stat. 1930, sec. 165a-17 (expenses of liquidation and preferred claims; secured claims to the extent of the security; all other debts; stockholders); Mont. L. 1927, c. 89, sec. 134 (expenses of liquidation, all funds held by the bank in trust; funds of other banks in process of liquidation and deposited with the particular failed bank by the Superintendent of Banks before insolvency, general liquidated debts, unliquidated claims); N. C. L. 1927, c. 113; sec. 1 (taxes and fees due the state, wages and salaries due officers and employees for four months last past; expenses of liquidation; certified checks and cashier's checks for collected items). For a typical statute regarding claims against decedent's estates, see Smith-Hurd Ill. Stat., c. 3, sec. 71 (funeral expenses and expenses of administration, widow's and children's award, expenses of last sickness and claims of laborers and household servants, debts due the common school fund or township, trust funds unaccounted for, all other claims). Sec. 104 of the federal Bankruptcy Act prefers claims as follows: the expense of preserving the estate, filing fees and the expense of recovering property, costs of administration, expenses of opposing a composition, wages of workmen, clerks, salesmen or servants for a limited period, taxes due the United States, a state, or subdivision of a state.

(e) A strong argument can be made for placing the loss from the failure of the collecting bank equally on the two parties who were to be the beneficiaries of the particular collection transaction. One of them sought the benefit of the bankers' collection system in order to pay his debt, the other in order to collect a debt. If the transaction had been successful, each would have received an advantage in the facility with which the debt was paid. Since the collection transaction failed in part, without the fault of either creditor or debtor, should they not jointly bear the loss? A weakness of this suggestion is, no doubt, that provisions for carrying it out would be cumbersome. To divide the loss between two persons requires more machinery than to place the loss on one party. Probably the result might best be accomplished by obliging the depositor of the paper for collection to prove as a general creditor against the failed bank, and then give him a cause of action against his old debtor, who had used the item to pay his debt, for one-half the loss sustained by the failure of the collecting bank. This would involve two actions or proceedings instead of one. The remedy against the maker or drawer of the collected paper in favor of the depositor for collection might well be illusory, because of the bank failure. All his assets might be eaten up by that disaster. If the maker or drawer objected that this joint responsibility would make him pay part of his debt a second time, the answer could often be given that he paid his debt by giving up a claim against an insolvent bank, and that this claim, if retained, would very shortly have been worth much less than par.

(f) A fairly strong argument on principle can be made for placing the risk of losses in collections on the whole class of beneficiaries of the country's collection system. It is the whole commercial class which gives and receives checks, drafts and other paper and which gets the benefit of the collection system. A very large percentage of the business of the country is done by paper and not by the use of currency. The commercial class, the buyers and sellers, lenders and borrowers, and others, get the great benefits in convenience, safety, and speed from the use of this paper system and its necessary concomitant, the bankers' collection system. The losses from failed collecting banks are necessary elements of this collection system, just as physical injuries to workmen are inevitable consequences of the modern manufacturing and industrial system. Just as the workmen's

compensation acts and similar legislation have placed these losses due to workmen's injuries on the employers, to be shifted by them to the customers of such employers through the media of higher prices, so a collection code might properly set up machinery for placing collection losses on the commercial classes which benefit from the use of commercial paper and the collection system. Here, again, the objection of impracticality, can, of course, be made. How provide for the distribution of these losses over the entire class using commercial paper? A possible procedure for accomplishing something of this effect would be to place the loss initially on the forwarding bank and allow it to distribute this loss through charges made to its customers for future collection or other banking service. Naturally banks are not desirous of undertaking this distribution, since it would doubtless occasion some friction between them and their customers.

As shown by the cases and statutes cited above, the distinct modern tendency is to throw the loss on the general creditors of the failed bank, persons who are not at all the beneficiaries of the particular collection transaction and are a relatively weak and minor class of the beneficiaries of the whole collection system of the country. This seems to the writer the least defensible result of the several possible choices.

Either placing the loss on the depositor of the item for collection or on the forwarding bank seems preferable on principle. Procedures for working out either of these results are practical. The depositor would shift his loss to his customers as a whole. The forwarding bank would distribute its loss among its depositors as a whole.

The only solution requiring a preference against the failed bank is that of placing the loss on the creditors of the failed bank. Here the preference, if resort must be had to it, can be worked out best on the basis of a preferred debt established by statute, or an equitable lien declared by statute. The illogical use of the trust terminology to accomplish the preference should be avoided. It works a detriment to the trust institution. It is not necessary if a federal statute is adopted to cover claims against national banks.⁴³

⁴³Under sec. 194 of the present federal banking act the rule for distribution of the assets of a failed national bank seems to be one of absolute equality,

CONCLUSIONS

1. The present tendency of decisions and statutes to place collection losses on the general creditors of failed collecting banks and to give a preference to a forwarder on a trust theory is to be deplored.

2. Such losses should be borne ultimately by as large a class of the commercial community as possible, and should be distributed to such class by the depositor for collection or the forwarding bank. No preference out of the assets of the failed bank is necessary to accomplish this placing and distribution of loss.

even as to claims owed to the United States with one slight exception. *Cook County National Bank v. United States*, 107 U. S. 445. A state statute attempting to give a preference against a defunct national bank, contrary to the federal statute, would be unconstitutional. *Davis v. Elmira Savings Bank*, 161 U. S. 275; *Steele v. Randall*, 19 F.(2d) 40; *Fiman v. State of South Dakota*, 29 F.(2d) 776; *Palo Alto County v. Ulrich*, 199 Iowa 1; *Central National Bank v. First National Bank*, 219 N.W. 894. An attempt by a state statute to give a preference against an insolvent national bank by declaring that the national bank was a trustee when it was not intended to be such and the primary elements of a trust were lacking, should be treated as a mere subterfuge, as an effort to do indirectly what the state could not do directly.