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An Indorsee for Collection As Trustee for the Proceeds in Missouri

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present article will follow in a later number of the LAW REVIEW.

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AN INDORSEE FOR COLLECTION AS TRUSTEE FOR THE PROCEEDS IN MISSOURI

The Oran bank, in the case of *Federal Reserve Bank v. Millspaugh,*[1] agreed with the Federal Reserve bank to remit in cash or acceptable exchange for all paper drawn on it and sent for "collection and remittance" by the Federal Reserve bank. Such remittance was to be made on the day that the Oran bank received the paper for collection. The Federal Reserve bank pursuant to the agreement sent items drawn on the Oran bank and indorsed "for collection and remittance" to the latter bank. Col-

[1] (1926), 314 Mo., 282 S. W. 706 the court in its opinion declared: "Here, as there, the facts disclose that no reciprocal accounts were kept between these banks, the respondent and appellant. When the relation existing between the banks, as in the case at bar, is that of principal and agent, the funds collected by the collecting bank become impressed with a trust in favor of the owner of the item collected. This is true although the item collected be one drawn on the collecting bank and is collected by charging the item against the drawee's account, or if it be an item payable at the collecting bank and is collected by a check drawn on it. The trust in either case follows the funds into the hands of the receiver—in this instance the financial commissioner—although the collecting bank may fail before remitting the proceeds collected providing these items exist: (1) That the item was forwarded for collection and remittance of the proceeds. (2) That the drawer of the check had a sufficient balance with collecting bank to authorize the charging of the item to his account. (3) That at the time the charge was made the collecting bank had sufficient funds available to honor the check. (4) That the bank which failed had sufficient funds on hands to pay the amount it had collected. Further than this the creation of the relation of principal and agent under the original agreement by the terms of which the proceeds of the funds collected were to be forwarded to the principal in currency or acceptable exchange did not change the relation to that of debtor and creditor by reason of an attempted remittance in uncollectible paper."

lection was made by a charge against the makers' accounts in the Oran bank, whose failure preceded the payment of a draft upon a third bank in favor of the plaintiff for such collection. Plaintiff was permitted a preference in the assets of the insolvent bank. "Where a note, a check or a draft is forwarded by one bank to another, bearing a restrictive indorsement 'for collection and remittance' under directions to collect and forward the proceeds to the sender, the relationship of principal and agent is created and not that of debtor and creditor. The funds thus collected are held to constitute a trust fund and entitled to a preference over the claims of general creditors." That the Missouri court, by the adoption of this view took a position far in advance of the English and most American courts was evident even to itself.[2]

The majority view has for its foundation the custom of banks to mingle the proceeds of collection items with general assets and to make an immediate debit entry upon their books, thereby rendering the specific res indistinguishable and creating the relation of debtor and creditor.[3] Knowledge of such a custom is presumed in the indorser, from which his intention to be regarded upon collection as a creditor is inferred.[4] The soundness of this view must rest upon an actual existence of such a custom, and the validity of the inferrential intent of the indorser to be regarded as a creditor. If by crediting the indorser is meant the completion of an entry in any record book of the bank, the courts have been justified in stating the existence of such a custom. But if such be the meaning, the custom can hardly be said,

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[2] First National Bank of Lapeer v. Sanford (1895), 62 Mo. A. 394. "We concede that this reasoning proceeds on advanced lines, and is seemingly opposed to the weight of authority in the other states." In commenting upon the decisions in Harrison v. Smith (1884), 83 Mo. 210 and Stoller v. Coates (1885), 88 Mo. 514 the court in Midland National Bank v. Brightwell (1899), 148 Mo. 358, 49 S. W. 994 says: "In going to this length unquestionably this court took a position in advance of the English chancery and most of the states of this Union, but with the soundness of this proposition we are satisfied."

[3] Bank v. Bradley (1926), 136 S. C. 511, 134 S. E. 510; California Packing Co. v. McClintock (1925), 75 Mont. 72, 241 P. 1077; National Bank v. Glanton (1917), 146 Ga. 786, 92 S. E. 336; Leach v. Iowa State Saving Bank (Ia., 1926), 211 N. W. 517; Lippit v. Thames Loan & Trust Co. (1914), 88 Conn. 185, 90 A. 369; Hecker Milling Co. v. Cosmopolitan Trust Co. (1922), 242 Mass. 181, 136 N. E. 333; Central Trust Co. v. Hanover Trust Co. (1922), 242 Mass. 265, 136 N. E. 336; Gonyer v. Williams (1914), 168 Calif. 452, 143 P. 736; First Nat'l Bank of Ventura v. Williams (1926), 15 Fed. (2d) 585; Smith & Co. v. Montgomery (1923), 209 Ala. 100, 95 So. 290; Commonwealth v. Tradesmen's Trust Co. (1915), 250 Pa. 378, 95 A. 577; Commercial Bank v. Armstrong (1892), 148 U. S. 50.

[4] See note 3, *supra.*

in every case, to designate the relationship contended for by the majority view. Bookkeeping is necessary, and to argue that a debit or credit entry in any record kept in indicative of an intention to be a debtor or creditor, and in fact does create such a relationship, is to advance a fallacy. It is submitted that many banks handle collection items through separate and distinct collection and transit departments which maintain their own records.[5] This system does not indicate a mingling of the proceeds with the general assets. The Federal Reserve banks maintain such separate departments and records and regard themselves as agents.[6] Moreover an indorsement "for collection and remittance" evidences a contrary intention. As between the two indices, the courts have not only pressed as inference from custom too far, but have utterly disregarded the expressed intention of the indorser. A restrictive indorsement contemplates retention of control of negotiable paper and assumes to create a fiduciary relationship as to the proceeds.[7] It appears that the courts have taken, in the face of an expressed communicative intent, a custom of doubtful existence, of which the parties are presumed to have knowledge, as the sole and unequivocal criterion of the intention of the parties. This criticism does not extend to the courts which, regardless of the restrictive indorsement, find the intention of the parties from a course of business between them, and thus deny a preference.[8] The fact that banks exact a charge for such service is not consistent with the debtor and creditor relationship.[9]

Some courts, especially those of the Federal government, refuse a preference where collection has been made by check upon the collecting bank or by charging the accounts of the drawees.[10]

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[5] ENCYCLOPEDIA OF BANKING AND FINANCE, p. 131 "Where the volume of out of town checks is large a separate department known as collection and transit department is created."

[6] Federal Reserve Board Regulation (1924) series, Regulation J., sec. V, par. 1. "A Federal Reserve bank will act only as agent of the bank from which it receives such checks and will assume no liability except for its own negligence and its guaranty of prior indorsements."

[7] Norton, BILLS & NOTES, pp. 168-172.

[8] Midland Nat'l Bank v. Brightwell (1899), 148 Mo. 359, 49 S. W. 994; American Bank of DeSoto v. People's Bank of DeSoto (Mo., 1923), 255 S. W. 943. For explanation of reciprocal accounts arrangement see Federal Reserve Bank v. Peters (1924), 139 Va. 45, 123 S. E. 379.

[9] Encyclopedia of Banking and Finance at p. 31. Collection charges are: "Charges by a bank for the collection of checks, coupons, drafts, notes and acceptances, drawn upon banks, corporations or individuals at points outside the city in which the sending bank is located."

[10] Rorebeck v. Benedict Flour & Seed Co. (1928), 26 Fed. (2d) 440; Dickson v. First Nat'l Bank (1928), 26 Fed. (2d) 411; Larabee Flour Mills v.

It is argued that before such a preference can be allowed it must be shown that the assets which come into the hands of the trustee in bankruptcy be actually increased.[11] It is no doubt true that a cestui que trust is entitled to the satisfaction of his claim if he can show that the trust fund or property into which it is converted came into the hands of the trustee in bankruptcy and increased the assets of the estate, even though the property is incapable of identification.[12] While the Federal courts are correct in their reliance upon this theory, they are hardly justified in indicating that an augmentation can occur only through a cash collection. It would apparently satisfy these courts if the drawee of the draft to be collected, wrote a check against his account in the collecting bank, received the money and then handed it back with instructions to pay the draft.[13] The absurdity of this is apparent. Furthermore it is difficult to see how the method of payment by a third party can prejudice the rights of the restrictive indorser as they previously existed. To insist upon such a rule is to press to extreme the requirement of an actual physical res. Banks and business concerns handle as little actual currency as possible. They have resorted to negotiable paper as a substitute and as a means of expediting business transactions.[14] Very seldom will the collection be made in cash. To require collection to be made in currency is to deter immediate collection and to impede the speedy consummation of business through the use of negotiable paper. Courts which require no actual cash collection reason that when there is a sufficiency in the accounts to be charged and in the vaults of the bank, it is in duty bound to appropriate the cash and to remit it to the endorser, and when it fails in this, it follows that by retaining the cash its assets are augmented.[15] This view is in line with the argument of the Mis-

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First Nat'l Bank of Henryetta (1926), 13 Fed. (2d) 330; American Can Co. v. Williams (1910), 178 Fed. 420; Mechanics & Metal Nat'l Bank v. Buchana (1926), 12 Fed. (2d) 891; Nyassa Dist. v. Bank (1921), 3 Fed. (2d) 648; Empire State Surety Co. v. Carroll County (1912), 194 Fed. 593; Freiberg v. Stoddard (1894), 161 Pa. 259; Peters Shoe Co. v. Murray (1903), 31 Texas Civ. App. 259, 71 S. W. 977.

[11] Larabee Flour Mills v. First Nat'l Bank of Henryetta (1926), 12 Fed. (2d) 133. See also cases *supra* note 10.

[12] Bogert, TRUSTS (1921), pp. 531-536.

[13] Darragh Co. v. Goodman (1916), 124 Ark. 532, 187 S. W. 673. "Certainly there is no necessity for the drawee of the draft to take its check to its bank, the collector, and present it and receive the money, and hand it back in payment of the draft."

[14] Wright, READINGS IN MONEY, CREDIT, AND BANKING PRINCIPLES (1926), p. 377. "It has frequently been estimated that from 90 to 95 per cent of all payments of money in the United States are made by checks drawn upon banks."

[15] Hawaiian Pineapple Co. v. Brown (1923), 69 Mont. 140, 220 P. 1114.

souri courts which have gone to the extreme of declaring such a retention and mingling of the funds a wrongful conversion.[16]

The Missouri doctrine rests upon the decisions of two cases, *Harrison v. Smith*[17] and *Stoller v. Coates*.[18] Both cases present facts not entirely similar to those of *Federal Reserve Bank v. Millspaugh*.[19] Neither involves paper sent for "collection and remittance," but rather a deposit of money in the form of a check in favor of the insolvent bank for a specific use which was never accomplished. In the *Harrison* case a series of communications resulted in the plaintiff sending a check payable to the bank to be used as a loan on a deed of trust. The bank, instead of indorsing the check to the borrower, sent it for collection to the bank on which it was drawn, receiving credit therefor, and in fact never executed the loan, although representations to the contrary were made by it before becoming insolvent. In the *Stoller* case a sum of money was deposited in the bank by means of a draft payable to the plaintiff who then made a check payable to the bank with instructions to establish credit in a distant bank for a third party. These cases as well as subsequent Missouri cases are silent as regards the custom of banks to credit the indorser and to mix the collected funds with the general assets as advanced by the majority view.[20] Both apply the rule that "an agent is bound to keep the property of the principal separate from his own; if he mixes it with his own, the whole may be taken both in law and equity to be the property of the principal until the agent puts the subject matter under such circumstances as that it may be distinguished."[21]

The factual situation in the case of *First National Bank of Lapeer v. Sanford*[22] is typical of that in *Federal Reserve Bank v. Millspaugh*. Items were sent for collection through a clearing house. At the time of collection and charge of the account an

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[16] Harrison v. Smith (1884), 83 Mo. 210; Stoller v. Coates (1885), 88 Mo. 514; Orr v. St. Louis Union Trust Co. (1922), 219 Mo. 383, 404, 236 S. W. 642; Tufts v. Tatshaw (1903), 172 Mo. 359, 373, 72 S. W. 679; Bircher v. Walther (1901), 163 Mo. 461, 63 S. W. 691.

[17] (1884), 83 Mo. 210.

[18] (1885), 88 Mo. 514.

[19] See note 1, *supra*.

[20] First Nat'l Bank of Lapeer v. Sanford (1895), 62 Mo. A. 394; Midland Nat'l Bank v. Brightwell (1899), 148 Mo. 358, 49 S. W. 994; American Bank v. People's Bank (Mo., 1923), 255 S. W. 943; Bank of Poplar Bluff v. Millspaugh (1926), 313 Mo. 421, 281 S. W. 733; Federal Reserve Bank v. Millspaugh (1926), 314 Mo. 1, 282 S. W. 706; State Farmers Mut. Tornado Ins. Co. v. Cantley (Mo., 1928), 6 S. W. (2d) 970; Bank of Portland v. McCredie Bank (Mo., 1928), 300 S. W. 1018.

[21] Harrison v. Smith (1884), 83 Mo. 210; see cases note 16, *supra*.

[22] (1895), 62 Mo. A. 394.

amount of money sufficient for remittance was present in the vaults of the bank, but at the time of assignment in insolvency this condition ceased to exist. A preference was allowed. The case was the first in Missouri to allow a preference on facts similar to those in *Federal Reserve Bank v. Millspaugh.* The court was guided in its opinion, which was afterwards refined by a requirement that funds in amount sufficient to cover the items sent be present in the vault of the defunct bank or to its credit in solvent correspondent banks at the time of failure,[23] by the *Harrison* case, which was cited as presenting a case precisely in point. This is true if we assume that sending paper for collection and remittance creates the same relationship to the proceeds as does sending a check upon a second bank to be applied in a manner prescribed by a course of correspondence between the parties. If we make this assumption, the decision rests solidly upon the *Harrison* and *Stoller* cases. Since the Missouri courts have never considered the view taken by the majority ruling, but have concerned themselves with contending that funds wrongfully mixed may be traced,[24] and that if the general assets of the bank have been increased by such wrongful conversion, a preference will be permitted,[25] they have apparently concluded that nothing need be said about an intention so clearly evidenced as that by paper sent for "collection and remittance."

Midland National Bank v. Brightwell[26] refused a preference because at the time the collection was made by charging the drawee's account, the total funds of the bank amounted to far less than the amount of items so collected. The court reasoned that since there was nothing upon which the charge could operate, there could be no swelling of the assets of the bank, and the mere transfering of a naked liability, in the absence of a res, from one person to another does not swell the assets of the bank. The doctrine rests upon the fact that no inference could be drawn that the assets in the hands of the receiver were the product of collections for the plaintiff. From this and other Missouri cases[27] it is plain that, while courts do not require a physical res to the extent of an actual cash increment, they do require it to be present in the funds of the bank both at the time of the charge and at the date of actual bankruptcy.

[23] Bank of Poplar Bluff v. Millspaugh (1926), 313 Mo. 412, 281 S. W. 733; Federal Reserve Bank v. Quigley (Mo., 1926), 284 S. W. 164.

[24] See cases note 16, *supra.*

[25] First Nat'l Bank of Lapeer v. Sanford (1895), 62 Mo. A. 394; Federal Reserve Bank v. Millspaugh (1926), 314 Mo. 1, 282 S. W. 706.

[26] (1899), 148 Mo. 358, 49 S. W. 994.

[27] American Bank of DeSoto v. People's Bank of DeSoto (Mo., 1923), 255 S. W. 943.

Some doubt was created as to the extent of the Missouri doctrine by the case of *American Bank of De Soto v. People's Bank of De Soto*.[28] Each bank honored checks made upon the other. A balance was struck and the checks returned to the respective banks to be charged against the makers' accounts. The court was of the opinion that there was never a relation of principal and agent, and that the checks were presented for payment and not for collection. The relation between a bank and depositor is that of debtor and creditor, and an order by the creditor to pay a third person does not constitute the latter a cestui que trust. The case was distinguished by that of *Federal Reserve Bank v. Millspaugh* as containing a reciprocal accounts arrangement, and thereby exposing a clear intention by the parties to become debtor or creditor as the balance might indicate.[29] While the reciprocal accounts feature is present in the *American Bank* case, the opinion indicated that its absence would not have altered the decision, and it is to that extent overruled by the case of *Bank v. Poplar Bluff v. Millspaugh*[30] and *Federal Reserve Bank v. Millspaugh*.[31] That "sufficient funds" as required by the Missouri court means funds in the vault of the insolvent bank or insolvent correspondent bank was established by the case of *Federal Reserve Bank v. Quigley*[32] by applying the dictum in the case of *Bank of Poplar Bluff v. Millspaugh*.[33]

The Missouri doctrine thus appears to be that in the absence of intention to the contrary, as designated by a reciprocal accounts arrangement, to send paper for "collection and remittance" creates the relationship of principal and agent which is not changed by any act of the agent in contravention of his au-

[28] (Mo., 1923), 255 S. W. 943.

[29] Federal Reserve Bank v. Millspaugh (1926), 314 Mo. 1, 282 S. W. 706. "Upon a certification of the Poplar Bluff case to this court the opinion of the Court of Appeals was, in a well considered opinion by Bradley in all things affirmed, and it was held that the opinion of the Court of Appeals in the ruling in the Poplar Bluff case did not conflict with that in the American Bank case *(supra)*, in that in the latter, it was shown that a reciprocal relation existed between the banks and not one of principal and agent. The same questions being involved in the Poplar Bluff case as in the instant case, it is not necessary to the determination of the case at bar to do more than state with approval the ruling principles announced in that case."

[30] (1926), 313 Mo. 412, 281 S. W. 733.

[31] It was there held that sending a check for collection is in fact constituting the bank an agent for collection from itself, and is not a presentation for payment.

[32] (Mo., 1926), 284 S. W. 164.

[33] "When the Slater Savings Bank drew its draft, and indorsed the one drawn by the Citizens Stock Bank, it did not have sufficient money in its vaults or *elsewhere* to pay its own draft on the one it indorsed."

thority by the method of collection, credit, attempted remittance or by mixing the proceeds with the general assets, provided funds sufficient to constitute a res exist in the insolvent bank or solvent correspondent banks at the time of charge and of insolvency. While the above doctrine may be a minority holding, the view is finding favor with courts of other states, and from the number of recent decisions holding in accord, it may in time be adopted by the majority of the courts.[34] This doctrine, whether its application of trust principles is justified or not, reaches a decision in accord with the intention of the parties and the practice of the business world in substituting negotiable paper and systems of accounts for actual currency transfers. Collection of a single draft aside from that by the Federal Reserve system may involve numerous banks and may take a circuitous route in reaching the bank upon which it is drawn.[35] The courts refusing a preference are in effect indicating that the owner of the paper intended to become a creditor of each bank through whom collection is to be made. The contest, after all, is between a distant owner of the paper and the depositors of the collecting bank. The latter presumably have made investigation and satisfied themselves as to the soundness of the bank. Certainly the opportunity for such has been present, as has that of constant surveillance. The former is in no position to do so and cannot reasonably be presumed to have done so. The two do not occupy the same position and to compel them to share *pari passu* is to take an inequitable view.

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[34] Hanover Nat'l Bank of N. Y. v. Thomas (Ala., 1928), 117 So. 42; Gentry County Drainage Dist. v. Farmer & Mechanics Bank (Mo., 1928), 5 S. W. (2d) 1110; Kesl v. Hanover State Bank (1921), 109 Kan. 776, 204 P. 994; Hawaiian Pineapple Co. v. Brown (1923), 69 Mont. 140, 220 P. 1114; Federal Reserve Bank of Richmond v. Bohannan (1925), 141 Va. 285; Federal Reserve Bank v. Peters (1924), 139 Va. 45, 123 S. E. 379; Goodyear Tire and Rubber Co. v. Hanover State Bank (1921), 109 Kan. 772, 204 P. 992; Murray v. North Liberty Savings Bank (1923), 196 Ia. 729, 195 N. W. 354; First Nat'l Bank v. Demin (1915), 20 N. M. 96, 146 P. 948; People's Bank v. Iuka State Bank (1923), 229 Ill. A. 4; State Bank v. First Nat'l Bank (1916), 124 Ark. 531, 187 S. W. 673; Rainwater Bank of Com. v. Federal Reserve Bank of St. Louis (Ark., 1927), 290 S. W. 69; State Farmers Mut. Tornado Ins. Co. v. Cantley (Mo., 1928), 6 S. W. (2d) 970; Bank of Portland v. McCredie Bank (Mo., 1928), 300 S. W. 1018.

[35] Moulton, PRINCIPLES OF MONEY AND BANKING (1916), p. 324, sec. 161; Wright, READINGS IN MONEY, CREDIT AND BANKING PRINCIPLES, p. 383.