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TRUSTS — CONSTRUCTIVE TRUSTS — PREFERENTIAL CLAIM AGAINST BANK'S ASSETS FOR DEPOSITS MADE AFTER HOPELESS INSOLVENCY — On proclamation by the governor of the so-called bank holiday, the Union Guardian Trust Company was closed as of February 11, 1933. The evidence showed that within nine months of closing the company had made provision for obtaining $2,500,000 by pledging assets, had received loans amounting to $12,000,000 from the Reconstruction Finance Corporation, and was conferring frequently with the officers of that agency to negotiate an additional $44,000,000 loan. Under the authority of emergency legislation [1] passed after the bank holiday, a conservator was appointed. By the plan of reorganization all the assets of the company were set aside in a fund designated as a depositors' and creditors' trust fund for liquidation by a trustee for the benefit of creditors. Plaintiffs seek to establish a preferential claim against the assets on the theory that the trust company's acceptance of their deposits while insolvent created a trust *ex maleficio* in favor of the plaintiffs. The lower court gave judgment for plaintiffs. On appeal, *held*, reversed. The trust company was not hopelessly or irretrievably insolvent when it accepted the deposits. *Union Guardian Trust Co. v. Emery*, 292 Mich. 394, 290 N. W. 841 (1940).

Although it was not a crime at common law for a bank officer to receive deposits when he knew the bank was insolvent, the application of ordinary fraud techniques furnished the defrauded depositors a preferential claim against the remaining assets on the theory of rescission and constructive trust.[2] The principal case is in accord with the general view that mere insolvency is not enough to support a preferential claim; it must be hopeless insolvency.[3] This has not always been the prevalent view as to banks, although it has been the standard usually applied to mercantile firms.[4] The test of hopeless insolvency is something different from the concept of balance sheet insolvency and probably different from either of the other two general concepts of insolvency: inability to pay debts in the usual course of business as they mature,[5] and inability to pay all obligations upon liquidation with a reasonable time.[6] The concept of hopeless insolvency, as the Michigan court interprets it, takes into account such factors as the possibility of loans to pay immediate demands, assuming that the bank can

[1] Mich. Pub. Acts (1933), No. 32, Stat. Ann. (1939), §§ 23.91-23.111. The commissioner of banks did not necessarily have to find the company was insolvent before he closed it, if he found it expedient to suspend operations.

[2] Burgess v. Forshar, 254 Mich. 531, 236 N. W. 853 (1931). The principal case extended the rule to apply to trust companies as well as banks. Newark Distributing Terminals Co. v. Hospelhorn, 172 Md. 291, 191 A. 707 (1937); St. Louis & San Francisco Ry. v. Johnston, 133 U. S. 566, 10 S. Ct. 390 (1890); Steele v. Commissioner of Banks, 240 Mass. 394, 134 N. E. 401 (1922).

[3] See annotation, 85 A. L. R. 811 (1933).

[4] See Bruner v. First Nat. Bank of Johnson City, 97 Tenn. 540, 37 S. W. 286 (1896), in which the court granted the preference without considering whether the insolvency was hopeless when the deposit was accepted. For cases regarding mercantile firms, see 85 A. L. R. 811 (1933).

[5] Cases collected 85 A. L. R. 811 (1933).

[6] Cases collected 85 A. L. R. 811 (1933).

market its securities more favorably later and thus meet its obligations.[7] Depositors who put money in the bank when the bank knows it is hopelessly insolvent are preferred over depositors who merely left their deposits in during the concealment of the insolvency, because the latter can more fairly be said to have accepted the risk that the bank would become insolvent. However, while it is almost impossible to calculate the loss, it is conceivable that those who deposited while the bank was solvent will lose more on account of the concealment of the later insolvency than they would have lost if the insolvency had been revealed when it first occurred. Therefore, since the equities of these two classes of depositors are nearly alike, the courts have tended in recent years to restrict the granting of preferences to depositors-after-insolvency over depositors-before-insolvency. The test of hopeless, rather than simple, insolvency has been adopted because it will more accurately reflect the presence or absence of the bank's original intention to pay when it accepted the deposits. Moreover, the hopelessness of the situation will be judged, not from hindsight, but from the point of view of the directors when they accepted the deposits.[8] Inasmuch as the adjustment of conflicting interests among various groups of depositors is explained in terms of fraud, it is at least logical to adopt these tests reflecting the presence or absence of actual fraud, and it is fortunate that these tests are more stringent than the former requirements for constructive trust against a bank, because the equities of the different classes of general depositors are about equal.

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[7] The facts in the record on which the court relied to show the bank was not hopelessly insolvent were not those relating to the underlying soundness of the bank's securities, but those relating to the possibilities of securing immediate loans to meet current demands. Since the bank was paying its current demands on the proceeds of extraordinary loans, it is possible to say that it was not, in the strictest sense, meeting its obligations in the ordinary course of business. Further, there was no evidence to show that if the bank were liquidated within a reasonable time it would have been able to meet all its obligations.

[8] The court expressly said that it judged the directors' actions from their point of view when the deposits were accepted. Cases in which hindsight was used to determine that the directors should have known the insolvency: Federal Reserve Bank of San Francisco v. Idaho Grimm Alfalfa Seed Growers' Assn., (C. C. A. 9th, 1925) 8 F. (2d) 922, cert. denied, 270 U. S. 646, 46 S. Ct. 347 (1926); Ream's Drug Store v. Bank of the Monongahela Valley, 115 W. Va. 66, 174 S. E. 788 (1934).