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BANKRUPTCY-SET-OFF-BANK DEPOSITS

A. E. Anderson S.Ed.
University of Michigan Law School

BANKRUPTCY—SET-OFF—BANK DEPOSITS—Endorsers of a corporation's notes caused the corporation to make deposits in the payee bank in the regular course of business, knowing the corporation to be insolvent, and the bank took over the deposits within four months of adjudication in bankruptcy. It was contended that under the amended definition of "transfer" as set out in section 1 (30) of the Bankruptcy Act of 1938, this transaction resulted in a voidable preference to the endorsers under section 60. The trial court rejected this contention. On appeal, *held*, affirmed. Although the 1938 amendment gave a broader significance to the term "transfer" than formerly was the case, it was not intended to effect any change in the accepted law as to bank deposits. *Hughes and Co. v. Machen*, (C.C.A. 4th, 1947) 164 F. (2d) 983.

It is generally recognized that a deposit made by an insolvent in a bank to which he is indebted is not a preferential transfer under section 60 of the Bankruptcy Act so as to nullify the bank's right of set-off, provided the deposit is made in the usual course of business to the checking account of the depositor.[1] There seem to be two essential elements which must be shown in order to make out a preferential transfer. First, it must be shown that the making of the deposit is a transfer within the meaning of section 60 (a) which enables the bank in making a set-off to obtain a greater percentage of its debt than do other creditors of the same class. A deposit made in the regular course of business and subject to complete freedom of withdrawal is held not to be such a transfer on two grounds: (1) It is not a "transfer" as defined in section 1 (30) and as used in section 60 of the act; [2] and (2) a policy of facilitating such transactions with banks is advisable.[3] It is submitted that the latter ground is more logical in view of the extremely broad verbiage of section 1 (30).[4] Second, assuming that such a deposit is a transfer, it must be shown under section 60 (b) that the bank had at the time of the deposit reasonable cause to believe the depositor was insolvent. As a practical matter this second element is seldom a bar to recovery because ordinarily when the deposit is held to be a preferential transfer, the bank knew of the depositor's insolvency and perhaps even procured the deposit; as a result the proof evidencing the first element usually includes the second.[5] Unless the indorser of a note held by the bank procured the deposit with the purpose of subjecting the maker's funds to the bank's right of set-off, he stands in the same position as the bank in regard to whether or not the transfer is preferential.[6] In the principal case there was no evidence disclosing any deliberate building up of the insolvent's bank account; the testimony indicated normal deposits made in the regular course of business.[7] In view of

[1] New York County Bank v. Massey, 192 U.S. 138, 24 S.Ct. 199 (1904); Studley v. Boylston Nat. Bank, 229 U.S. 523, 33 S.Ct. 806 (1913); Citizens Nat. Bank v. Lineberger, (C.C.A. 4th, 1930) 45 F. (2d) 522; Kane v. First Nat. Bank, (C.C.A. 5th, 1932) 56 F. (2d) 534. See 85 A.L.R. 369 (1933) and cases cited.

[2] New York County Bank v. Massey, 192 U.S. 138, 24 S.Ct. 199 (1904); Citizens Nat. Bank v. Lineberger, (C.C.A. 4th, 1930) 45 F. (2d) 522. The reason assigned for this holding is that there is no diminution of the insolvent's estate because he receives an equivalent credit which is immediately available to him. It seems obvious that a deposit constitutes a transfer of property, and that the real reason is that it is not a preferential transfer under section 60.

[3] See Studley v. Boylston Nat. Bank, 229 U.S. 523, 33 S.Ct. 806 (1913); 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES, § 407 (1940).

[4] Section 1(30) provides: "'transfer' shall include the sale and every other different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift, security, or otherwise."

[5] Stevens v. Bank of Manhattan, (C.C.A. 2d, 1933) 66 F. (2d) 502; Bain v. Indiana Nat. Bank, (C.C.A. 7th, 1933) 64 F. (2d) 112. In general see 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES, § 407 (1940).

[6] Drugan v. Crabtree, (C.C.A. 4th, 1924) 299 F. 115, and cases cited.

[7] The endorsers were officers of the bankrupt corporation and therefore in a posi-

these facts it seems clear that the court reached the logical conclusion. The changes made by the Chandler Act of 1938 in the definition of "transfer" can hardly be said to have been intended to change the law applicable to the set-off of bank deposits. The obvious place to amend this branch of the law would be in section 68 of the act, dealing with set-off.[8]

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tion to build up the corporation accounts in the banks holding its notes had they so desired.

[8] Such an amendment was proposed [H.R. 12889, 74th Cong., 2d sess. (1936)] but was rejected in the House.