Preferences Arising from Trust Relations

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PREFERENCES ARISING FROM TRUST RELATIONS

Where property has once been impressed with a trust, the quality inheres therein and in the proceeds thereof so long as the trust relation continues, provided the rights of a bona fide purchaser for value and without notice do not intervene and identification remain possible. The trust impress, in the absence of a superior equity, at once places property in the preferred class. In equity, trust property belongs to the cesiui que trust, and his claim to it cannot be defeated by the insolvency or dishonesty of the trustee, if it constitutes, in an identifiable form, a part of the trustee's estate. It goes without saying that, under such circumstances, it is beyond the reach of the general creditors of the trustee. In order that this doctrine may be applied and a preferential claim for trust property enforced against the estate of an insolvent, it is not necessary that the relation between the insolvent and the claimant be technically that of trustee and cestui que trust. It may be a quasi trust relation, such, for example, as that existing between principal and agent or bailor and bailee. Further, in order to defeat fraud and in the interests of honesty and fair dealing, equity may thrust the trust relation upon a party. Whenever the title to property has been fraudulently obtained, it is, in equity, held by the transferee for the benefit of the defrauded party; and an appeal to the proper equitable remedy will always be sustained whenever the remedy furnished by the law is inadequate. The proceeds of negotiable securities, for example, that have been stolen and sold, may be impressed with a trust in the hands of the felonious taker or his assignee with notice. Equity, in such a case, "will raise a trust in invitum out of the transaction, for the very purpose of subjecting the substituted property to the purposes of
If the property that is the subject of a trust, either express or implied, is in the possession of the insolvent trustee, or his assignee for the benefit of creditors, or if the proceeds thereof have been invested in other property that can be clearly identified as a part of the insolvent's estate, the problem is an easy one. The property, whether in its original or in a changed form, belongs in equity to the *cestui que trust*, and the court of equity will protect his interests as against general creditors. But when trust property has become so mingled with the private property of the trustee that identification in specie or by way of substituted property becomes impossible, the problem assumes a more complicated form. It is with this phase of the subject that this article will principally deal.

To what extent and under what circumstances will equity recognize and enforce a preferential lien in favor of a *cestui que trust* as against the general estate of an insolvent?

In the discussion of the question and in an examination of cases bearing thereon, we should keep before us a few fundamental principles. It is quite apparent that a failure to do this has resulted in extreme views that have led to confusion. In order that a preference may be enforced in favor of a *cestui que trust*, it is obvious that the facts of the case must show a trust relation and not simply the relation of debtor and creditor. In the absence of a trust relation, there can, of course, be no *cestui que trust*. And the trust relation must be connected with property. After the dissipation of property that has been the subject of a trust, the trust relation, although perhaps formally in existence, is in reality, so far as property is concerned, at an end. Under such circumstances, the *cestui que trust* becomes simply a general creditor. It is identifiable property to which the trust attaches, that gives the relation life and that forms the basis of a preferential claim. Excepting as his claim is connected with property that constitutes a part of the estate of the insolvent, the trust creditor is not entitled to preference over general creditors. The mere fact that a claim has arisen out of a trust relation, either express or implied, does not, of itself, give a right to preference. "It is clear," says the court in *Matter of Cavin v. Gleason*, "that upon an accounting in bankruptcy or insolvency, a trust creditor is not entitled to a preference over general creditors of the insolvent, merely on the ground of the nature of his claim, that is, that he is a trust creditor as distinguished from a general creditor.

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We know of no authority for such a contention. The equitable
doctrine that as between creditors equality is equity, admits, so far
as we know, of no exception founded on the greater supposed
sacredness of one debt, or that it arose out of a violation of duty,
or that its loss involves greater apparent hardship in one case than
another, unless it appears in addition that there is some specific,
recognized equity founded on some agreement, or the relation of
the debt to the assigned property, which entitles the claimant,
according to equitable principles, to preferential payment."\(^1\)

As the right of a trust claim to preference depends, not upon the
mere nature of the claim, but upon the fact that the trust funds, or
their proceeds, have gone into the insolvent estate, and still remain
a part thereof, it follows that the important question in every case
must be as to what constitutes a sufficient tracing and identification
of such funds. There has undoubtedly been a material liberalizing,
within recent years, of the rule in regard to the following of trust
property. Formerly such property could be followed only so long
as specific identification was possible and the rights of the bona fide
purchaser for value and without notice, had not intervened. The
equity attached only to the property misappropriated. The first
change in the rule subjected the proceeds of the property to the
equitable claim, provided their identification as proceeds were pos-
sible; but if the proceeds became confused with other property of
the same kind, so as not to be distinguishable as proceeds, the
right to follow was lost. If, for example, the trust property were
turned into money, and the money were mixed with the personal
funds of the trustee, by being deposited in a bank to the credit of
his personal account, the identity of the trust property was held to
have been lost. Money can have no ear-mark, and by a mingling
of it, its identity is gone. This was the argument. Some of the
American courts still adhere to this rule.\(^2\)

But what has been called "the modern doctrine of equity" has
changed the old rule to the extent that confusion of funds "does not
destroy the equity entirely, but converts it into a charge upon the
entire mass, giving to the party injured by the unlawful diversion a

Rep. 443.

v. O'Brien, 140 Ill. 146; Mutual Accident Association v. Jacobs, 141 Ill. 261; Bayer v. American
Trust & Savings Bank, 157 Ill. 62; Lanterman v. Travous, 174 Ill. 459; Thompson's Appeal,
22 Pa. St. 16; Goodell v. Buck, 67 Me. 514; Portland etc. Steamboat Company v. Locke, 74 Me-
370.
priority of right over the other creditors of the possessor.” In order, however, that a priority of right may be sustained, the property impressed with the trust, or its proceeds, must be traced to the mass.

This modern doctrine in regard to the tracing of trust funds is now very generally followed in this country. Although it had been decided as early as 1853 in England that the rights of a cestui que trust to the funds of the trust could not be defeated by a mingling of such funds with others of a like nature belonging to the trustee personally, the subject did not receive an elaborate review there until 1879, when the case of Knatchbull v. Hallett was decided by the Court of Appeal. The impetus that the doctrine has received in this country is undoubtedly due in a large degree to the vigorous judgment in that case of Sir George Jessel, Master of the Rolls. The fiduciary relation in the case grew out of bailment and agency. Bonds in the hands of a solicitor were without authority sold by him and the proceeds deposited to the credit of his personal account at his banker’s. At the time of his death this money was in the bank, mingled with his own funds. The beneficiary claimed to be entitled to receive the amount of the proceeds of the bonds out of the money in the hands of the bankers at the time of the solicitor’s death. In the course of his judgment upon this state of facts, the Master of the Rolls explains what he calls the “modern doctrine of equity” in regard to the tracing of trust funds. The scope of the rule, as formulated by this distinguished equity judge, and the reasoning upon which he bases his conclusions can best be given in his own language:

“The modern doctrine of equity as regards property disposed of by persons in a fiduciary position is a very clear and well-established doctrine. You can, if the sale was rightful, take the proceeds of the sale, if you can identify them. If the sale was wrongful, you can still take the proceeds of the sale, in a sense adopting the sale for the purpose of taking the proceeds, if you can identify them. There is no distinction, therefore, between a rightful and a wrongful disposition of the property, so far as regards the right of the beneficial owner to follow the proceeds. But it very often happens that you cannot identify the proceeds. The proceeds may have been invested together with money belonging to the person in a fiduciary position, in a purchase. He may have bought land with it, for instance, or he may have bought chattels with it. Now, what is the position of the beneficial owner as regards such purchases? I will, first of all, take his position when the purchase is

2 Pennell v. Deffell, 4 De Gex, Mac Naughten & Gordon, 372.
clearly made with what I will call, for shortness, the trust money, although it is not confined, as I will show presently, to express trusts. In that case, according to the now well-established doctrine of equity, the beneficial owner has a right to elect either to take the property purchased, or to hold it as security for the amount of the trust money laid out in the purchase; or, as we generally express it, he is entitled at his election to take the property, or to have a charge on the property for the amount of the trust money. But in the second case, where a trustee has mixed the money with his own, there is this distinction, that the cestui que trust, or beneficial owner, can no longer elect to take the property, because it is no longer bought with the trust money simply and purely, but with a mixed fund. He is, however, entitled to a charge on the property purchased for the amount of the trust money laid out in the purchase; and that charge is quite independent of the fact of the amount laid out by the trustee. The moment you get a substantial portion of it furnished by the trustee, using the word 'trustee' in the sense I have mentioned, as including all persons in a fiduciary relation, the right to the charge follows. That is the modern doctrine of equity."

"The moment you establish the fiduciary relation, the modern rules of equity, as regards following trust money, apply." "If the bailee sells the goods bailed, the bailor can in equity follow the proceeds wherever they can be distinguished, either being actually kept separate, or being mixed up with other moneys. I have only to advert to one other point, and that is this:—supposing, instead of being invested in the purchase of land or goods, the moneys were simply mixed with other moneys of the trustee, using the term again in its full sense as including every person in a fiduciary relation, does it make any difference according to the modern doctrine of equity? I say none. It would be very remarkable if it were to do so. Supposing the trust money was 1000 sovereigns, and the trustee put them into a bag, and by mistake or accident or otherwise, dropped a sovereign of his own into the bag. Could anybody suppose that a judge in equity would find any difficulty in saying that the cestui que trust has a right to take 1000 sovereigns out of that bag? I do not like to call it a charge of 1000 sovereigns on the 1001 sovereigns, but that is the effect of it. It would make no difference if, instead of one sovereign it was another 1000 sovereigns; but if instead of putting it into his bag, he carries the bag to his bankers, what then? According to law, the bankers are his debtors for the total amount; but if you lend the trust money to a third person, you can follow it. If in the case supposed the trustee had lent the 1000 pounds to a man without security, you could follow the debt, and take it from the debtor. If he lent it on a promissory note, you could take the promissory note; or the bond, if it were a bond. If, instead of lending the whole amount, in one sum simply, he had added a sovereign, or had added 500 pounds of his own to the 1000 pounds, the only difference is this, that instead of taking the bond or the promissory note, the cestui que trust would have a charge for the amount of the trust money on the bond or promissory note. So it would be on the simple contract debt; that is, if the debt were of such a nature as that, between the creditor and the debtor, you could not sever the debt into two, so as to shew what part was trust money, then the cestui que trust would have a right to a charge upon the whole. Therefore, there is no difficulty in following out the rules of equity and deciding that in case of a mere bailee . . . . you can follow the money."
It is also decided in this case that if a person holding money in a fiduciary capacity deposits it to the credit of his personal account, and thereby mixes it with his own money, and afterwards draws out sums by checks in the ordinary manner, he must be taken to have drawn out his own money in preference to the trust money.

The doctrine of Knatchbull v. Hallett, although probably more liberal than anything upon the subject previously announced from the bench, and perhaps, for that reason, entitled to be called "modern," is not a departure in principle from the old rule. It recognizes that the basis of the preferential trust claim must be trust property, not necessarily trust property that can be identified in specie or in a substituted form, but trust property that can at least be identified as having gone into a larger mass and as still remaining a part thereof. The case holds, in effect, that where specific identification becomes impossible, because the property is no longer ear-marked, equity will furnish a means of ascertainment by impressing a lien upon the entire mass into which the trust property has been traced. The trust claim, under such circumstances, is preferred, not because it is a trust claim, but because it is attached to property that through the processes of equity is capable of ascertainment. The doctrine of this case simply enforces, through the refinement of equity, the fundamental principle of the old rule under conditions that formerly were generally thought to be such as to make the enforcement impracticable.

The supreme court of the United States, approving and following the case of Knatchbull v. Hallett, holds that the trust quality of funds collected by an agent is not destroyed by his depositing them in a bank and thereby mingling them with his own funds; that the principal, in that case an insurance company, might enforce its beneficial ownership in the funds as against the bank, which claimed a lien thereon for a debt due to it, from the agent the circumstances of the case being such as to charge the bank with notice of the agency. "This doctrine of equity," says the court, "is modern only in the sense of its being a consistent and logical extension of a principle originating in the very idea of trusts, for they can only be preserved by a strict enforcement of the rule that forbids one holding a trust relation from making private use of trust property."

Ordinarily, of course, the deposit of funds in a bank creates the relation of debtor and creditor between the bank and the person

making the deposit; and the fact that the deposit is of trust funds does not necessarily change the relation, even though the bank has notice of the character of the deposit. In order that the relation may become one of trust so that the depositor may have a preferential claim upon the funds of the bank, it must appear either that a trust has been raised in invito on account of the fraud of the bank, or that the deposit was a special one, or that the circumstances of the deposit were such as to make it special in effect although not so in form. 1

This modern doctrine in regard to the tracing of trust funds has been very generally recognized and applied in this country. 2 The doctrine itself is simple, but its application is often difficult. In many cases the rule, though approved, is not applied because of the failure of the cestui que trust to show that the estate of the insolvent contains the proceeds of the trust property. 3 The limits of this article will not admit of any systematic review of the American cases upon the subject. Nothing will be attempted except a brief description of some of the situations to which the doctrine has been applied by our courts and the discussion of a few cases in which it has been arbitrarily extended beyond the reasons that support it.

The principle of the modern rule is frequently invoked where commercial paper has been deposited with a bank for collection, and the bank is either hopelessly insolvent at the time or becomes insolvent while holding the paper or the proceeds thereof. The question in such a case is as to whether or not a trust relation that will entitle the owner of the paper to a preferential claim as against general creditors has been raised. If the title to the paper passes to the bank, the former owner, in the absence of fraud on the part of the bank, loses all interest therein and in the proceeds thereof. In case of insolvency he becomes simply a general creditor. For

1 Paul v. Draper, 158 Mo. 197, 59 S. W. Rep. 77.
example, if, by agreement, either express or implied, the collecting bank at once, upon receiving paper for collection, credits it to the account of the depositor, and the latter has the right at once to draw against it, the relation established is that of debtor and creditor. That relation, however, cannot be raised simply by the act of the collecting bank in treating the paper as a general deposit. It results only from an express or implied agreement. Where the course of dealing between two banks shows a custom of mutual credits of paper sent for collection, the amounts collected by each being mingled with its general funds, the relation between them in regard to such amounts is that of debtor and creditor. But when commercial paper is accepted by a bank simply for collection, the bank acts in the capacity of an agent, and if the proceeds of the paper can be shown to form a part of the assets in the hands of a receiver, the one for whom the collection has been made will be held to be a preferred creditor by reason of the trust relation. But it has been held that where money collected by a bank under instructions to make the collection and return the proceeds at once, is allowed to remain for several months with the collecting bank which becomes insolvent without having returned the funds, the bank for which the collection was made will be treated as an ordinary creditor. This decision was based upon the fact that identification had become impossible.

While it is undoubtedly the law that upon a deposit in a bank, in the ordinary course of business, of money, or of drafts or checks, the title to the money or to the drafts or checks passes immediately to the bank, yet if such deposit is made when the bank is irremediably insolvent, its officers knowing of its condition, a fraud is practiced upon the depositor that changes the relation to that of trust. Under such circumstances the deposit or the proceeds, if in the assets of the bank or in the hands of any one who is not a bona fide holder for value, may be reclaimed by the depositor.

The relation of partners to one another in regard to the partnership property being of a fiduciary character, it not infrequently

happens that the application of the modern rule as to the tracing of trust funds becomes necessary in the settlement of partnership affairs. The partnership relation is one that calls for the exercise of the greatest good faith. The wronged partner is always entitled to the same remedy that would exist in behalf of the cestui que trust in the case of a regularly constituted trust relation. He has the right, therefore, to follow partnership funds that have been wrongfully used by a copartner and to follow property into which they have been converted, together with the increased value thereof, provided ascertainment within the requirements of the rule is possible and the rights of the bona fide purchaser for value have not intervened. Through the application of these principles, it was held in *Holmes v. Gilman*¹ that where a member of a firm without authority used the funds of the firm to procure insurance on his life for the benefit of his wife, paying the premiums of the policies wholly out of such funds until his death, the surviving member, as the representative of the partnership, was entitled to the whole amount of the insurance, the amount thereof being less than the amount of the firm funds misappropriated.

A preferential lien, through the medium of the implied trust, will be declared in favor of a defrauded vendor of goods, where it appears that he has no adequate remedy at law, and the proceeds of the goods are clearly traced to the hands of the fraudulent and insolvent vendee, or his assignee for the benefit of creditors. In a recent leading case in which this question was involved, it appeared that goods had been sold upon fraudulent representations by the purchasers as to their financial standing. The fraud was clearly shown, and, indeed, was not controverted. Among the assigned assets were some of the goods sold. These were repleived by the vendor. But prior to the assignment, the fraudulent vendees had sold upon credit to numerous persons, in the ordinary course of trade, portions of the goods, and claims against the sub-vendees arising out of such sales, aggregating a considerable amount, passed to the hands of the assignee. After the assignment, these claims were collected by the assignee. The proceeds in his hands were capable of ascertainment. Excepting as to a small sum, these collections were made after notice of rescission for fraud of the original sale and a demand for the goods sold that were then in the possession of the assignee and for an accounting and the delivery to the defrauded vendor of the outstanding claims against the sub-

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HeinOnline -- 1 Mich. L. Rev. 9 1902-1903
vendees. An interlocutory judgment making the assignee a trustee of the proceeds and ordering him to “account for, transfer and pay over to the plaintiff all of said proceeds,” was sustained by the court of last resort. The principle upon which the decision was based is that through the fraud of the vendees a trust was raised in favor of the vendor that attached to the property which was the subject matter of the transaction and to the ascertainable proceeds thereof in the hands of the fraudulent vendees, and that so far as this property or the proceeds passed to the assignee, it passed impressed with this trust. The trust had not been rendered ineffective by the dissipation of the property and its proceeds. Priority was given, not by reason of the character of the claim but by reason of the equitable ownership of the property and proceeds. “The court in such cases lays hold of the substituted property and follows the original fund, through all the changes it has undergone, until the power of identification is lost or the rights of bona fide purchasers stop the pursuit, and holds it in its grasp to indemnify the innocent victim of the fraud. And even in the case of money, which is said to have no ear-mark, its identity will not be deemed lost, though it is mingled with other money of the wrongdoer, if it can be shown that it forms a part of the general mass.”

It was urged in this case in denial of the power of the court of equity to impound the proceeds for the benefit of the defrauded vendor, that to admit such an equitable principle into commercial transactions would be contrary to public policy. But as to this the court says that, safeguarded by the limitations that “it must appear that the plaintiff has no adequate remedy at law, either in consequence of insolvency, the dispersion of the property or other cause, and that nothing will be adjudged as proceeds except what can be specifically identified as such, business interests will have adequate protection,” and further that “the disturbance would be much less than is now permitted in following the property from hand to hand until a bona fide purchaser is found.”

In case it appears that before the rescission of a sale induced by the fraud of the vendee, the subject matter thereof has passed into the hands of a bona fide purchaser for value without notice and that the proceeds of the re-sale cannot be traced to the estate of the insolvent, equity will not impress that estate with a lien for the benefit of the seller. His right to preference being based solely upon an equitable interest in property, raised through the fraud of

1 American Sugar Refining Co. v. Fancher, 145 N. Y. 552.
the vendee, it logically follows that the right must disappear with the dissipation of the property. Whenever the trust property or the trust fund resulting therefrom has passed beyond the reach of the court, the right to preference is gone.

This modern rule in regard to the tracing of trust funds is clearly within well settled equitable principles. The danger lies in its application. If in this the courts would always keep within the reason of the rule, and would not attempt, on account of some vague equity that a case may present, to extend the doctrine beyond its legitimate field, there would be little uncertainty or confusion. Unfortunately, however, a few courts, enthusiastic, perhaps, to contribute something to the "progressive, refined and improved" doctrines of equity, have, in their application of the rule, carried it to an extreme that fails of support in principle and that leads inevitably to most illogical and inequitable results.

In 1884, the court of appeals of the State of New York pronounced a decision that apparently extended the preferential trust lien to the general estate of the insolvent, even though the trust funds could not be specifically traced to the estate, if such funds had gone into the business of the insolvent and so benefited the estate. The profession very generally understood this to be the effect of the decision, and several courts of last resort, undoubtedly influenced by it, announced this as a proper extension of the modern rule. It appears, in this case, that a firm, having discounted certain notes at a bank where it was a depositor and desiring to anticipate payment, gave to the bank its checks for the amount of the notes, $8000, less rebate of interest; that the bank charged the checks in the firm account and made an entry in the bank books to the effect that the notes had been paid. At that time the firm supposed that the bank held the notes, but they had, in fact, been previously sold. Before the notes became due and about a month after the giving of the checks, the bank failed, and a receiver was appointed. The bank did not pay the notes and the receiver refused to do so without an order of the court. It does not appear that a specific fund was set aside for that purpose by the bank.

The receiver found "in the vaults of the bank considerably less than $8000," how much less is not disclosed, but before the peti-

3 The People v. The City Bank of Rochester, 96 N. Y. 32.
tion for the payment of the notes had been presented to the court, he had received about $75,000. There is nothing in the reported case to show that the proceeds of the checks given by the firm, or anything representing them, passed into the hands of the receiver. The court held that the transaction created a trust relation between the firm and the bank, the violation of which constituted a fraud by which the bank could not profit; "that the checks were impressed with a trust, and no change of them into any other shape could divest it so as to give the bank or its receiver any different or more valid claim in respect to them than the bank had before the conversion;" and that an order requiring the receiver to pay the notes out of the funds in his hands was properly granted. In 1887, this court, in considering the question of trust preferences, held that to entitle the trust creditor to preference, it must appear that the property of the insolvent remaining for distribution includes the trust fund or its proceeds. In the course of the opinion, it is said that the case of People v. City Bank of Rochester, seems to have been misunderstood; that it was not claimed in that case that the proceeds the checks "had not gone into the general funds of the bank, or that they had not passed in some form to the receiver. The court did not decide that the petitioners would have been entitled to a preference in case the proceeds of the checks had been used by the bank, and were not represented in its assets in the hands of a receiver." The court by this later decision puts into the case of People v. City Bank of Rochester an element that, to say the least, "does not distinctly appear in the reported decision, and declared a rule as to preference arising from trust relations that is based upon principle.

But before the publication of the explanatory decision, the apparent doctrine of People v. City Bank of Rochester had gained headway in the courts. In McLeod v. Evans the supreme court of Wisconsin held that the owner of a draft left with a banker for collection was entitled by reason of the trust relation raised by the agency and the fraud of the banker, to a preferential lien upon the estate of the banker in the hands of his assignee for the benefit of creditors, even though the proceeds of the draft formed no part of the estate, it appearing that such proceeds had been used in paying debts of the insolvent. The reasoning upon which this conclusion rests, is that as the trust fund had been useu

2 McLeod v. Evans, Assignee, 66 Wis. 401.
by the insolvent in the payment of debts, the estate in the hands of
the assignee was thereby increased by that amount, and in equity
should be impressed with a lien to the extent of the fund. "Beyond
time all controversy," says the court, "the proceeds of the draft . . .
were a trust fund. He (the banker) having used them
in his business, having benefited his estate by such use, as we must
assume, a trust attaches to that estate which came to the defendant
under the assignment." The reasoning is plausible but unsound.
It ignores the fundamental principle that the very life of the trust
relation as the basis of a preferential claim depends upon the exist-
ence of property, impressed with the trust, that is capable of
specific identification or that is a part of a larger mass. It assumes
that the payment of debts by the insolvent, with trust funds, would
increase the assets that went into the hands of the assignee, to an
extent that would make the allowance of a lien upon the general
estate in favor of the cestui que trust for the amount of his claim
just and equitable, an assumption that the situation fails to sustain.
The payment of debts would in a general way benefit the estate by
increasing the per cent that creditors would receive. But in case of
a badly insolvent estate, like the one under consideration, the
extent of the benefit, as suggested by Judge Cassoday in his vigor-
ous dissenting opinion, would be very much less than the amount
of the trust claim. In reality, the use of the trust funds in the pay-
ment of individual debts would not increase at all the estate passing
to the hands of the insolvent's assignee. It would simply change
the indebtedness. The cestui que trust would become a creditor in
place of the creditors that had been paid with the trust funds. It
must be apparent, as suggested by the supreme court of Rhode
Island, that the satisfaction of one debt by incurring another of
equal amount, neither decreases one's liabilities nor increases his
assets.1

But the supreme court of Wisconsin, after following the doctrine
of McLeod v. Evans in the cases cited, Judges Cassoday and
Taylor always recording their dissent, finally overruled its
former decisions, and placed itself squarely in line with the doctrine
that in order that a trust claim may be entitled to preference, it
must at least appear that the property of the insolvent includes
proceeds of the trust estate; that the use of such proceeds in the
payment of the debts of the insolvent does not raise an equity in

1 See Slater v. Oriental Mills, 18 R. I. 352; 27 Atl. Rep. 443; Francis v. Evans, 69 Wis. 115,
dissenting opinion, 33 N. W. Rep. 93; Bowers v. Evans, 71 Wis. 133, 135, dissenting opinion.
favor of the trust claimant as against the general creditors. In subsequent cases this court has steadily adhered to this doctrine.

The supreme court of Kansas in *Peak v. Ellicott*, decided in 1883, apparently carried the modern doctrine to an extent that cannot be justified by principle. It held in that case that the deposit of a fund with a bank with instructions that it be used by way of anticipating the payment of a note given to the bank by the depositor creates a trust relation between the depositor and the bank in regard to this specific fund. To this extent the decision was undoubtedly correct. But the court further held that upon an assignment by the bank for the benefit of its creditors, the depositor had the right to reclaim from the assignee the amount of the fund to be paid out of assets in his hands, although it does not appear in the reported case that any part of the fund could be traced to the assets that passed to the assignee. That the modern doctrine, according to this court, does not necessarily involve at least the tracing of the trust fund into a larger mass of property of the same kind, is apparent from its opinion in the subsequent case of *Meyers v. The Board of Education*. In this case the court held that a board of education had a preferred right over general creditors to assets in the hands of an assignee of an insolvent bank, where the deposit of the funds of the board was made by its treasurer, who was also cashier of the bank, without special authority from the board, the owner of the bank knowing the character of the funds, even though no part of the funds passed to the assignee, they having been wrongfully used in the business of the bank and in the payment of indebtedness against it. But the Kansas court, in a later case, while not formally overruling *Meyers v. Board of Education* and *Hubbard v. The Irrigation Co.*, declared that these cases carried "the doctrine of the impressibility of insolvent estates with trusts to the full length." The doctrine of the court was restated as follows: "The fund itself, or something into which it has gone, and which stands as its representative, must be on hand, subject to identification and separable from the general assets, in order to charge the assignee with the trust; or, if the fund has been so commingled with the general assets as to be incapable of identification or tracing, the estate which came to the assignee must have

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1 Nonotuck Silk Co. v. Flanders, 87 Wis. 237.
2 See Burnham v. Barth, 89 Wis. 362; Thuemmler v. Barth, 89 Wis. 381; Stevens v. Williams, 91 Wis. 58; Dowie v. Humphrey, 91 Wis. 98; Hyland v. Roe, 111 Wis. 56.
3 Peak v. Ellicott, 30 Kans. 159.
4 Meyers v. Board of Education of City of Clay Center, 51 Kans. 87; see also, Hubbard v. The Irrigation Co. 53 Kans. 657.
been augmented or bettered, in an appreciable and tangible way, in order to charge it with the trust. The mere saving of the estate by the discharge of general indebtedness otherwise payable out of it, or by the payment of the current expenses of the business, is not an augmentation or betterment of the estate, within the meaning of the rule. If the estate has not been increased by specific additions to it, or if what previously existed has not been improved or rendered more valuable, it has not been impressed with the trust claimed."

This restated doctrine was recognized and followed in the subsequent case of *Kansas State Bank v. First State Bank.* It is to be regretted that the abandonment by this court of an indefensible position was not complete. The language used in the restatement of the doctrine of the court is such as to leave an opportunity for misunderstanding and confusion. To say that in order that a preferential trust claim may be enforced against the estate of an insolvent, the estate through the use of trust funds by the insolvent "must have been augmented or bettered in an appreciable and tangible way," is to set indefinite and probably changing limitations upon the former doctrine of the court, particularly in view of the fact that *Meyers v. Board of Education* and *Hubbard v. The Irrigation Company* are distinguished "rather than criticized as containing any error of decision." And the danger of confusion is but partially averted by the statement that the saving to the estate by the payment of general indebtedness or current expenses out of trust funds, "is not an augmentation or betterment of the estate, within the meaning of the rule."

The doctrine of the Iowa supreme court in regard to preferential trust claims, as given in the *Davenport Plow Company v. Lamp.* is not less extreme than that promulgated in the earlier Wisconsin and Kansas cases. In this case the treasurer of the plaintiff corporation made an unauthorized loan of funds to another corporation, the defendant's assignor, the president of the latter corporation well knowing that the loan was without authority. The money so obtained was mingled with the funds of the defendant's assignor, and was used to pay its debts. None of the funds loaned, or their proceeds, came to the hands of the assignee for the benefit of creditors. It was held that the funds loaned were, under the circumstances, impressed with a trust, and

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3 See *The Davenport Plow Company v. Lamp,* 60 Iowa, 722.
that as they were used by the defendant's assignor in its business and in the payment of its debts, it became liable "to replace the trust funds with other money in its possession or with money realized out of other property," and that the assignee was under obligations to pay the loan in full out of the assets in his hands before making a pro rata distribution to the other creditors.1 The doctrine of the Iowa court was somewhat modified by a subsequent case in which the court said: "We do not think it is necessary to trace the deposit into any specific property in the hands of the assignee in order to establish a trust, but it should be shown, presumptively at least, that the estate in his hands has been augmented by the trust fund. The equities of the plaintiff as against property to which its money contributed nothing, directly or indirectly, are no greater than those of the general creditor."2 It is hardly necessary to suggest that the change amounts to but little in the way of putting the court upon a sound basis in regard to preferential trust liens.3 However, the court goes further in the right direction in the subsequent cases of Jones v. Chesebrough, and Bradley v. Chesebrough.4

It is apparent that in a few courts the modern doctrine as to the tracing of trust funds has been carried to an extent that cannot be justified by reason or authority. The courts that have gone to an extreme in this matter have doubtless been unduly influenced by what they have considered to be the superior equity attaching to a trust claim. Trust property is held for the benefit of the cestui que trust, and the conscience of the trustee is charged with a duty which a court of equity should enforce, whenever it can do so without infringing upon the rights of others, by compelling the trustee to account for the property in accordance with the obligations of the trust. This the court of equity can always do when the trustee is solvent, and when he is insolvent, the court can do it, if the trust property is ascertainable as a part of his estate; but, where the trust property has been dissipated, the trust claim can have preference as against general creditors only upon the theory that the nature of the claim entitles it to special consideration, a theory that is based upon sentiment, and not upon principle, and that fails to recognize the binding force of the maxim that equality is equity.

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1 See also The Independent District of Boyer v. King, 80 Iowa, 497.
2 District Township of Eureka v. Farmers' Bank, 88 Iowa, 194.
3 See, also, Thompson v. Gloucester City Savings Institute, 8 All. Rep. (N. J.) 97.
4 Jones v. Chesebrough, 105 Iowa, 303; Bradley v. Chesebrough, 111 Iowa, 126.