

COMMENT ON RECENT DECISIONS

BANKS AND BANKING—UNIFORM FIDUCIARIES ACT—LIABILITY OF BANK ACCEPTING FIDUCIARY MONEY IN PAYMENT OF LOAN OR OVERDRAFT—[District of Columbia].—Three joint fiduciaries drew a check in the amount of their entire joint fiduciary account payable to one of the fiduciaries personally. The check was endorsed by the payee and deposited in its personal account. Part of deposit was used to pay an existing overdraft in the personal account, and a substantial portion of the balance was checked out the same day in payment of the bank's personal loan to the fiduciary. Both applications of the fiduciary fund were in breach of trust, and the beneficiaries of the trust sued the bank for participation in that breach. The court held that under section 9 of the Uniform Fiduciaries Act¹ the form of the check did not give the bank constructive notice that the funds deposited in the personal account were trust funds; that the bank did not participate in the breach of trust by accepting payment of its loan in the form of a check drawn on these trust funds, the measure of its liability being actual knowledge of the misappropriation and no actual knowledge having been shown; but that the Uniform Fiduciaries Act did not apply to the payment of the overdraft, and that under the applicable common-law rule the bank was chargeable with constructive notice of its receipt of trust funds in payment of a private debt and hence liable to the *cestuis que trust* for the amount of that payment.²

By the weight of authority at common law the mere fact that a check is drawn on fiduciary funds, made payable to the fiduciary personally, and deposited by the fiduciary in his personal account, is not in itself sufficient to put the depository on inquiry and make it liable if, in fact, the funds are later checked out in breach of trust.³ An important exception to this rule is generally made, viz. if the money deposited in the fiduciary's personal account is in fact fiduciary money and if the bank accepts this money in payment of either an overdraft or a loan which it had extended to the fiduciary personally, it is then held chargeable with notice that the deposit

1. Section 9 provides: "If a fiduciary make a deposit in a bank to his personal credit of checks drawn by him on an account in his own name as fiduciary, * * * the bank receiving such deposit is not bound to inquire whether the fiduciary is committing a breach of his obligation as fiduciary; and the bank is authorized to pay the amount of the deposit or any part thereof upon the personal check of the fiduciary without being liable to the principal, unless the bank receives the deposit or pays the check with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in making such deposit or drawing such check, or with knowledge of such facts that its action in receiving the deposit or paying the check amounts to bad faith."

2. *Colby v. Riggs Nat. Bank* (App. D. C., 1937) 92 F. (2d) 183.

3. See for a review of the authorities, Merrill, *Bankers' Liability for Deposits of a Fiduciary to his Personal Account* (1927) 40 Harv. L. Rev. 1077, 1079-1085. Accord, Restatement, *Trusts* (1935) sec. 324 (d) and (g).

represented fiduciary funds and is liable to the extent that such funds are used to pay the fiduciary's debt to the bank.⁴

The issue in *Colby v. Riggs National Bank*⁵ was whether or not this exception to the general rule was modified by the Uniform Fiduciaries Act, which was adopted in the District of Columbia in 1928.⁶ The court demonstrates that the authority given banks in section 9 of the Act to *pay* fiduciary funds deposited in a fiduciary's personal account upon the personal check of the fiduciary without being liable to the principal (absent dishonesty and actual knowledge of the misappropriation) includes the payment of a fiduciary's personal check drawn in favor of the bank itself. There has been no other decision on this point under the Act.

As to the payment of the fiduciary's overdraft, the court rejected the bank's argument that the transaction was covered by section 6⁷ of the Act. The principal argument of the court is that the cancellation of the overdraft was merely an incidental result of the deposit of the check, a "bookkeeping arrangement of credits and debits,"⁸ and that the intent of the Act was only to deal with negotiable instrument transactions.⁹ On this point two of the justices dissented.¹⁰

In the only two cases¹¹ in which a similar overdraft transaction has been involved under the Act, the courts have split on the question of the bank's liability. Both courts applied section 9 of the Act. The bank in the instant case relied on section 6. A Pennsylvania court simply stated that the bank

4. United States Fidelity and G. Co. v. Union Bank (C. C. A. 6, 1913) 228 Fed. 448; First Nat. Bank v. Greene (Ky., 1908) 114 S. W. 322; Allen v. Puritan Trust Co. (1922) 211 Mass. 409, 97 N. E. 916; Bischoff v. Yorkville Bank (1916) 218 N. Y. 106, 112 N. E. 759; but see United States Fidelity and G. Co. v. Bank (1918) 77 W. Va. 665, 88 S. E. 109; Restatement, *Trusts* (1935) sec. 324 (h).

5. (App. D. C., 1937) 92 F. (2d) 183.

6. Dist. of Columbia Code (1930) Title 11, ch. 3. See 9 U. L. A. 146 for a list of the 15 states that have adopted the Act since it was approved by the National Conference of Commissioners on Uniform State Laws in 1922.

7. The relevant portion of section 6 provides: "If a check * * * is drawn by a fiduciary as such * * * payable to the fiduciary personally * * * and * * * transferred thereafter by the fiduciary, whether in payment of a personal debt of the fiduciary or otherwise," [the transferee is not liable, except where it acts in bad faith or has actual knowledge that the fiduciary is committing a breach of trust].

8. *Colby v. Riggs Nat. Bank* (App. D. C., 1937) 92 F. (2d) 183, 201.

9. Note that the court did not say that the indorsement of the check for deposit was not a "transfer" of negotiable instrument within the meaning of sec. 6.

10. *Colby v. Riggs Nat. Bank* (App. D. C., 1937) 92 F. (2d) 183, 201. Their view was expressed as follows: "It gives too fine a literalness to the language of the Acts to say that a check is not transferred in payment of a personal debt because after it is deposited to the credit of the account which is overdrawn, a bookkeeping transaction must be made to accomplish the payment."

11. *Pennsylvania Co. for Insurance, etc., v. 9th Bank and Trust Co.* (1932) 306 Pa. 148, 158 Atl. 251; *New Amsterdam Cas. Co. v. National, etc., Banking Co.* (1934) 117 N. J. Eq. 264, 175 Atl. 609.

had knowledge of all the facts essential to show a breach of trust;¹² by which the court seems to mean actual knowledge—a statement which the facts given in the opinion do not substantiate. A New Jersey court held that the payment of the overdrafts as a result of the deposits did not amount to bad faith.¹³ Inasmuch as actual knowledge had not been alleged and constructive knowledge had been ruled out by section 9, the banks were held not liable.

The failure of the Pennsylvania court to apply section 6 was criticized in very strong language.¹⁴ Close examination, however, indicates that neither the language of section 6 nor that of section 9 covers the payment of an overdraft out of a deposit of fiduciary funds in a personal account.

The former section deals only with *transfers* of checks in payment of a personal debt of the fiduciary or otherwise. Where a check is presented by the payee to the bank on which it is drawn, and is received as a deposit and credited to the payee's account, this amounts in the absence of fraud or mutual mistake to a payment of the check.¹⁵ Payment in due course by or on behalf of the principal debtor discharges a check.¹⁶ The indorsement of a check by the payee on receipt of payment from the drawee is neither a negotiation nor a transfer of the instrument; it is a mere receipt in discharge of the instrument.¹⁷ Section 9 speaks only of paying "the amount of the deposit or any part thereof upon the personal check of the fiduciary." Since no other section of the Act is at all in point, the conclusion indicated is that unless a court wishes to base its holding purely on the spirit¹⁸ of the Act, it will be forced to agree with the court in the principal case in holding that the transaction is not covered by the statute.

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12. *Pennsylvania Co. v. 9th Bank and Trust Co.* (1932) 306 Pa. 148, 158 Atl. 251, 252.

13. *New Amsterdam Cas. Co. v. National, etc., Banking Co.* (1934) 117 N. J. Eq. 264, 175 Atl. 609, 619-620.

14. Note (1933) 81 U. of Pa. L. Rev. 863.

15. *American Nat. Bank v. Miller* (C. C. A. 6, 1911) 185 Fed. 338, aff'd. 229 U. S. 517, 33 S. Ct. 883, 57 L. Ed. 1310; *Montgomery County v. Cochran* (C. C. A. 5, 1903) 126 Fed. 456; *Bartley v. State* (1898) 53 Neb. 310, 73 N. W. 744.

16. *Negotiable Instruments Law*, sec. 119 (1).

17. Bigelow, *The Law of Bills, Notes, and Checks* (3d ed. 1928) 129. See *Sands v. Hill* (1873) 55 N. Y. 18, 22, where the court says: "There is no meaning of the word transfer which carries the idea of an act of extinction; or any other idea, than that of the bearing over of a right or title or property in a thing, from one to another."

18. The Commissioners' notes say, by way of summary: "The purpose of sections 7, 8, and 9 is to lay down a definite rule, making the bank, where it acts solely as depository, liable only if it has actual knowledge of the fiduciary breach of duty or if it acts in bad faith; and where the bank acts as creditor, making it liable to the same extent as other creditors are made liable." The liability of creditors is dealt with in sections 4, 5, and 6, under section 6, which most nearly covers the defendant bank's situation, a creditor is stated to be not liable.