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DEPARTMENTAL PRIORITIES IN ASSETS OF INSOLVENT BANKS

DESPITE the modern bank's diverse functions, its assets are still treated by the laws of a few states¹ as a single homogeneous fund in which all of its customers may share alike in the event of insolvency. But the legislatures and courts of most states have felt that particular assets or amounts of assets should be held for the prior protection of the customers of one or another of the bank's different departments. In these states the determination of which assets should be held for the security of which creditors, and of the extent to which one class of the bank's customers should be preferred over another or allowed to participate in assets derived from transactions with that other, has given rise to a multitude of problems. The great dissimilarity which characterizes the various legislative and judicial solutions of these problems bears witness to the influence of many economic, social and legal policies.

1. Alabama, Arizona, Arkansas, Colorado and Tennessee. Even in these states, of course, property held by the bank in trust is exempt from the claims of its creditors. See notes 41 and 67, *infra*.

Special protection for savings depositors is founded principally upon the view that they are typically persons of small means, ill-fitted to bear the loss occasioned by a bank's insolvency,² and possibly also upon the alleged belief of the average savings depositor that the money he deposits remains his own property, free from the risks attendant upon the operation of the commercial or trust departments.³ Fourteen jurisdictions, classing all savings depositors together,⁴ accord them a priority⁵ in the assets identifiable as those acquired through the operations of the savings department.⁶ Such assets, which are

2. *In re Prudential Trust Co.*, 240 Mass. 478, 482, 134 N. E. 253, 254 (1922); *Reichert v. Farmers' & Workingmen's Bank*, 257 Mich. 500, 505, 242 N. W. 239, 241 (1932).

3. REP. SPECIAL COMMISSION ON REVISION OF LAWS RELATING TO . . . LIQUIDATION OF BANKS (Mass. 1932) 31.

4. Christmas savings club members are ranked as savings depositors in Connecticut and Massachusetts. *Lippitt v. Thames Loan & Trust Co.*, 88 Conn. 185, 90 Atl. 369 (1914); *In re Hanover Trust Co.*, 242 Mass. 343, 136 N. E. 112 (1922).

5. This priority is not necessarily the highest given to any claimant. The word priority is used herein to describe the relative status of the claims of the ordinary savings depositor, commercial depositor, and cestui que trust. The claims of these broad classes are often inferior to those of smaller subclasses of special creditors, who enjoy every conceivable level of priority in the different states. *Expenses of liquidation*: MONT. REV. CODE (Choate, Supp. 1927) § 6014.134 (prior to all other claims); N. C. CODE ANN. (Michie, 1931) § 218c-14 (prior to all except wage and tax liens); *In re Prudential, Cosmopolitan and Hanover Trust Cos.*, 244 Mass. 64, 138 N. E. 702 (1923) (prior to all except savings depositors). *Public deposits*: MINN. STAT. (Mason, 1927) § 7715 (priority above all); *State v. Farmers' Exchange Bank of Gallatin*, 56 S. W. (2d) 129 (Mo. 1932) (pari passu with all other preferred creditors); MONT. REV. CODE (Choate, Supp. 1927) § 6014.134 (pari passu with all depositors and contract creditors); Ga. Laws 1927, p. 199 (inferior to depositors); Note (1932) 41 YALE L. J. 432. *Deposits of liquidators of insolvent banks*: WIS. STAT. (1931) § 220.08 (7) (prior to any other deposits); Ore. Laws 1931, c. 278, § 30 (priority on equality with any other priority). *Deposits of savings banks in other banks*: MINN. STAT. (Mason, 1927) § 7715 (prior to all except government deposits); N. Y. BANKING LAW (1914) §§ 278, 414 (pari passu with all other preferred claims). *Laborers' liens and wages*: N. C. CODE ANN. (Michie, 1931) § 218(c) (14) (higher than everything except taxes); MD. ANN. CODE (Bagby, 1924) art. 11, § 48 (inferior to fiduciary liabilities). *Taxes*: N. C. CODE ANN. (Michie, 1931) § 218(c) (14) (nothing higher); *Shippee v. Riverside Trust Co.*, 113 Conn. 661, 156 Atl. 43 (1931) (partly ahead of and partly behind savings depositors). *Collection items*: IOWA CODE (1931) § 9239-c1 (first priority in all the assets of the bank); Mich. Pub. Acts 1931, No. 240, § 13; *Reichert v. Fidelity Bank & Trust Co.*, 261 Mich. 107, 245 N. W. 808 (1932) (first priority, but only in assets of own department); MONT. REV. CODE (Choate, Supp. 1927) § 6014.134 (pari passu with depositors); *In re Claim of Otumwa National Bank*, 91 Pa. Super. 495 (1927) (inferior to depositors); Note (1932) 41 YALE L. J. 432. *Certified and cashier's checks*: N. C. CODE (Michie, 1931) § 218 (c) (14) (higher than depositors; lower than wage and tax liens); Ore. Laws 1931, c. 278, § 27 (pari passu with depositors). *Judgment liens secured prior to bank's failure*: *Guaranty Fund Commission v. Teichmeier*, 119 Neb. 387, 229 N. W. 121 (1930) (prior to everything).

6. CAL. GEN. LAWS (Deering, 1931) Act 652, § 27; CONN. GEN. STAT. (1930) § 3908; Hawaii Sess. Laws 1931, Act 177, §§ 71, 120; IDAHO CODE (1932) § 25-1407 (applies only to trust companies which do no commercial banking business); ME. REV. STAT. (1930) c. 57, §§ 89, 90; MASS. ANN. LAWS (Michie, 1932) c. 172, § 62; MICH. COMP. LAWS (1929)

required to be segregated, include not only the securities purchased with the money obtained from the savings depositors, but also the securities and paper acquired by the commercial department and transferred for value to the savings department,⁷ and those assets required in some states to be set aside out of profits as a guaranty fund for savings depositors.⁸ In addition to this protection, a few states require that a portion of the capital stock and surplus be allocated to the savings department as if it were a separate bank.⁹ The effect of such a provision upon savings depositors in the event of the bank's insolvency is not clear; but it would appear to give them a first claim upon the assets which, at the time of the allocation, represented the portion of capital stock and surplus allotted to the savings department.¹⁰ The allocation of capital stock, moreover, usually carries with it a priority in a corresponding portion of the money derived from the enforcement of stockholders' liability.¹¹

§ 11928; MINN. STAT. (Mason, 1927) § 7667; N. H. LAWS 1929, c. 37, § 1; ORE. CODE ANN. (1930) § 22-2004; R. I. GEN. LAWS (1923) c. 272, § 1, cl. XVI-a; TEX. REV. CIV. CODE (Vernon, 1928) art. 430, 433; WASH. REV. STAT. (Remington, Supp. 1933) §§ 3244-1, 3246; WYO. REV. STAT. (1931) § 10-130. Some of these statutes have been interpreted. *Lippitt v. Thames Loan & Trust Co.*, *supra* note 4; *Glidden v. Rines*, 124 Me. 286, 128 Atl. 4 (1925); *In re Prudential Trust Co.*; *Reichert v. Farmers' and Workingmen's Bank*, both *supra* note 2; *Bank Commissioners v. Security Trust Co.*, 75 N. H. 107, 71 Atl. 377 (1908).

7. *Bieringer-Hanauer Co. v. Cosmopolitan Trust Co.*, 247 Mass. 73, 141 N. E. 566 (1923); *Dole v. Chattabriga*, 82 N. H. 396, 134 Atl. 347 (1926). But the income on the savings department assets is not included. *Bassett v. Merchants' Trust Co.*, 115 Conn. 364, 161 Atl. 785 (1932). Nor are assets transferred from the commercial department without payment of value included. *Ibid.*

8. MASS. ANN. LAWS (Michie, 1932) c. 172, § 64 (5% of deposits); N. H. PUB. LAWS (1926) c. 261, § 18; N. H. LAWS 1929 c. 37, § 1 (5% to 10% of deposits); R. I. GEN. LAWS (1923) § 4035 (5% of deposits).

9. CAL. GEN. LAWS (Deering, 1931) Act 652, § 23; ORE. CODE ANN. (1930) § 22-524; WASH. REV. STAT. (Remington, Supp. 1933) § 3244-1. In Michigan a portion of capital and surplus is required to be allocated jointly to the commercial and savings departments. MICH. COMP. LAWS (1929) § 12019.

10. The statutory mandate to treat the divided capital stock and surplus "as if each department was a separate bank" could not be literally obeyed without keeping separate books for each department. In order that such books might balance, each department would have to receive an amount of assets corresponding to the amount of capital and surplus so allocated. The assets thus received by the savings department would presumably become subject to the segregation requirement and to the savings depositors' priority.

Massachusetts gives savings depositors equal priority with *cestuis que trustent* in the bank's entire "capital stock." MASS. ANN. LAWS (Michie, 1932) c. 172, §§ 55, 63. This is defined as the money paid by the original stock subscribers. *In re Prudential, Cosmopolitan and Hanover Trust Cos.*, *supra* note 5. As to the difficulties raised by such an interpretation, see notes 46 and 47, *infra*.

11. The requirement that the capital stock allocated to each department be treated as if each department were a separate bank would appear to confer such priority. *Reichert v. Fidelity Bank & Trust Co.*, *supra* note 5, in effect overruling *Reichert v. Farmers' & Workingmen's Bank*, *supra* note 2. Except in Washington, where stockholders' liability

Access to assets derived by the bank from the operations of the commercial or trust department is accorded savings depositors upon varying terms. Such depositors are given what amounts to a priority in the commercial department assets when they are allowed to set off commercial department loans against savings accounts; similar inter-department set-offs, with resulting priorities in the savings assets, are usually denied to commercial depositors.¹² Ordinarily, however, savings depositors may share in the general assets of the other departments¹³ only as general creditors¹⁴ and only in accordance with the so-called "bankruptcy rule," which permits them to prove on the basis of the balance of their claims.¹⁵ The few courts that have considered application of the alternative "equity rule," which would permit the savings depositors to prove in the general assets on the basis of their full claims,¹⁶ have concluded that the adoption of this rule would imperil the usual security afforded commercial depositors,¹⁷ or would constitute a greater departure from the general statutory requirement of ratable distribution of assets than the language of the priority statute demands.¹⁸ The claim which savings depositors may assert upon the assets of other departments stands on a different footing, however, when the statute requiring segregation therefrom of the savings assets has not been

is prepaid. WASH. REV. STAT. (Remington, Supp. 1933) § 3229-2. Stockholders' liability in Massachusetts follows the capital stock. MASS. ANN. LAWS (Michie, 1932) c. 172, § 63. *In re Prudential, Cosmopolitan and Hanover Trust Cos.*, *supra* note 5.

12. The problem of priority for savings depositors through inter-department set-offs has been developed elsewhere. Moore and Sussman, *Current Account and Set-Offs between Insolvent Bank and its Customers* (1932) 41 YALE L. J. 1109, at 1130; Note (1932) 32 COL. L. REV. 1224, 1229; (1932) 42 YALE L. J. 143.

13. "General assets" is here used to include assets in which no individual creditor, class of creditors, or department has been given priority, and also all assets remaining after such priorities, if given, have been satisfied. Identifiable trust funds are not regarded as assets of the trust department. See notes 41 and 67, *infra*.

14. ME. REV. STAT. (1930) c. 57, § 90; MASS. ANN. LAWS (Michie, 1932) c. 172, § 63; *In re Cosmopolitan, Hanover and Prudential Trust Cos.*, *supra* note 5; *Bank Commissioners v. Security Trust Co.*, *supra* note 6. In Connecticut, however, they enjoy joint priority with commercial depositors, second only to the possible priority of cestuis of court trusts (see notes 42 and 53, *infra*). CONN. GEN. STAT. (1930) §§ 3885, 3935; *Lippitt v. Thames Loan and Trust Co.*, *supra* note 4. In Hawaii and Oregon, savings depositors have a priority in commercial department assets after commercial depositors have been paid in full. HAWAII SESS. LAWS 1931, Act 177, § 119; ORE. CODE ANN. (1930) § 22-2003.

15. See first two statutes and cases, *supra* note 14. In Michigan savings depositors share in the general assets on the basis of their full claims, but only after all other creditors have been paid as large a percentage of their claims as the savings depositors have realized by virtue of their priority in savings department assets. *Reichert v. Farmers' & Workingmen's Bank*, *supra* note 2; (1932) 30 MICH. L. REV. 1334.

16. For a critical discussion of the bankruptcy and equity rules, see Note (1924) 8 MINN. L. REV. 232; *In re Farmers' & Merchants' Bank of Imperial*, 292 Pac. 665 (Cal. App. 1930).

17. *In re Cosmopolitan, Hanover and Prudential Trust Cos.*, 241 Mass. 346, 353, 136 N. E. 269, 271 (1922).

18. *Reichert v. Farmers' & Workingmen's Bank*, *supra* note 2.

observed. At the very least, the savings depositors in such event may attempt to "trace" the savings department assets into the general mass and so to recover them as funds impressed with a trust because of the illegality of the mingling.¹⁹ But since the success of "tracing" too often depends upon the fortuitous ebb and flow of credit transactions,²⁰ some states further shield savings depositors from financial misfortune by giving the savings department an absolute priority in all the assets of the bank to the extent that savings department assets were mingled therein.²¹

Commercial depositors have not ordinarily been accorded special favors. Although it may be argued that commercial deposits are the business enterprisers' liquid assets, loss of which would interfere with industry and commerce, and although legislative efforts to lure depositors from national banks might be expected to make such provisions more general,²² only three jurisdictions have given commercial depositors a priority in the assets resulting from the operation of their own department.²³ Of these three states, two have required a portion of the capital stock and surplus to be allocated to the commercial department, so that that department, like the savings department, might be treated as if it were a separately capitalized bank;²⁴ these two states thus probably confer upon commercial depositors a priority in the assets which represented their share of capital and surplus at the time of allocation.²⁵ Moreover, two of the three allow the commercial depositors a prior claim upon the crumbs from the table of the savings depositors after the latter have fully satisfied themselves

19. *Peters v. Union Trust Co.*, 131 Mich. 322, 91 N. W. 273 (1902).

20. For more detailed discussion of tracing theories and presumptions see notes 56-64, *infra*.

21. N. D. LAWS 1931, c. 96, § 48 a-c, e (enjoyed only by "Secured Savings Deposits," limited to \$500 principal and 2½% interest). A Massachusetts case, *In re Prudential Trust Co.*, *supra* note 2, accomplishes the same result by invoking a segregation statute, MASS. ANN. LAWS (Michie, 1932) c. 167, § 42, which is practically identical with MICH. COMP. LAWS (1929) § 11928, in force when the *Peters* case, *supra* note 19, was decided. The other statutes listed, *supra* note 6, which are very similar to these two statutes, have not yet received interpretation on this point.

22. Cf. Editor's comment, OHIO GEN. CODE (Page, Supp. 1933) p. 53 (§ 710-31); Comment (1934) 43 YALE L. J. 454, 458.

23. CAL. GEN. LAWS (Deering, 1931) Act 652, §§ 26, 27; Hawaii Sess. Laws 1931, Act 177, § 119; ORE. CODE ANN. (1930) § 22-2003. The recency of these statutes suggests a trend in favor of such priorities. A similar statute for Massachusetts has been recommended, chiefly on the ground that neither savings depositors nor commercial depositors expect that the former will be allowed to share in the assets of the commercial department. REP. SPECIAL COMMISSION, *op. cit. supra* note 3, at 31, 92.

In distributing commercial department assets Michigan gives commercial depositors priority over all general creditors, including general creditors of the trust department, except that their priority over savings depositors terminates when they have received as large a percentage of their claims as the savings depositors have realized from the savings department assets. *Reichert v. Fidelity Bank & Trust Co.*, *supra* note 5; *Reichert v. Farmers' & Workingmen's Bank*, *supra* note 2; cf. note 15, *supra*.

24. CAL. GEN. LAWS (Deering, 1931) Act 652, § 23; ORE. CODE ANN. (1930) § 22-524.

25. See note 10, *supra*.

from the savings department assets.²⁶ A small number of states have classed commercial and savings depositors together. On the theory that special protection for all depositors is desirable to help prevent runs,²⁷ and to induce depositors to supply the funds without which banks and industry could not exist,²⁸ these states have bestowed upon them a priority in all of the assets of the bank,²⁹ including, in some instances, the sums derived from enforcement of the stockholders' liability.³⁰ Two other states give depositors a preference in the joint assets of the commercial and savings departments and require that a portion of capital stock be allotted jointly to those departments to be "held solely for the repayment of depositors."³¹ Since capital stock as such is not an asset, the exact nature of the priority thus conferred is left undefined.³²

A modern bank assumes the duties and obligations of a trustee under a wide variety of circumstances. Its trust funds include not only those held by its trust department by the appointment of a court³³ or of a private deed of trust,³⁴ but also those designated "deposits for a special purpose," which are handled by the commercial department;³⁵ and between these extremes various kinds of trust moneys are to be found, cared for sometimes in one department

26. Hawaii Sess. Laws 1931, Act. 177, § 120; ORE. CODE ANN. (1930) § 22-2004.

27. *Cf.* State v. Farmers' State Bank of Polk, 121 Neb. 547, 549, 237 N. W. 862, 863 (1931).

28. State v. Corning State Savings Bank, 127 Iowa 198, 204, 103 N. W. 97, 99 (1905); Metropolitan Life Insurance Co.'s Appeal, 310 Pa. 17, 24, 164 Atl. 715, 717 (1932).

29. Ga. Laws 1927, p. 199; IOWA CODE (1931) § 9239; Miss. Code (Harrison, Supp. 1933) § 3847-3; NEB. COMP. STAT. (1929) § 8-1102 (unsecured depositors only); PA. STAT. ANN. (Purdon, 1930) tit. 7, § 483. These statutes have been interpreted in State v. Corning State Savings Bank, *supra* note 28; Guaranty Fund Commission v. Teichmeier, *supra* note 5; Commonwealth v. American Trust Co., 39 Pa. Cy. 469 (1912).

30. GA. CODE (Michie, 1926) § 2366 (71); NEB. COMP. STAT. (1929) § 8-1102; Town of Douglasville v. Mobley, 169 Ga. 53, 149 S. E. 575 (1929). *Contra*: IOWA CODE (1931) § 9254 (all creditors share equally). In South Carolina, depositors have priority in stockholders' liability although they have none in the assets of the bank. S. C. CONSR. (1895) art. 9, § 18; S. C. CODE (Michie, 1932) § 7855-6; Biltrite Building Co. v. Elliott, 166 S. C. 534, 165 S. E. 340 (1932).

31. OHIO ANN. CODE (Page, 1926) § 710-168; OKLA. STAT. (Harlow, 1931) § 9233 (includes a corresponding portion of stockholders' liability).

32. The priority here conferred may be the same as that resulting from the allocation of capital stock among departments as if each department were a "separate bank." *Cf.* note 10, *supra*. Or it may operate upon all the assets of the bank to an amount equal to the portion of capital stock allocated to those departments. *Cf.* note 47, *infra*.

33. These are the so-called "court trusts," as distinguished from all kinds of trusts created by private persons or by the automatic operation of law. Trusts executed under the appointment of wills are also usually classed as court trusts. People v. California Safe Deposit & Trust Co., 22 Cal. App. 69, 133 Pac. 324 (1913).

34. These are known as "living trusts" or "voluntary trusts." HERRICK, TRUST DEPARTMENTS IN BANKS AND TRUST COMPANIES (1925) 14.

35. These are often referred to as "trust" funds and treated as such by the courts. E.g., Townsend v. Athelstan Bank, 212 Iowa 1078, 237 N. W. 356 (1931); *In re* Central Bank & Trust Co. v. Ritchie, 120 Wash. 160, 206 Pac. 926 (1922). Strictly they are not,

and sometimes in another.³⁶ Accordingly, most of the states which grant special protection to cestuis que trustent carry it beyond the limits of the trust department.³⁷ Despite the prevalence of the trust as a business device, beneficiaries of all of these trusts have profited from the familiar dogma of equity that cestuis que trustent are persons economically weak and peculiarly in need of protection;³⁸ although perhaps an equally important explanation of the favoritism shown them lies in state efforts to attract remunerative trust business away from the national banks.³⁹ Many legislatures have enacted statutes declaring that trust funds shall not be liable for the debts of the bank,⁴⁰ thus

for the parties expect the bank to mingle the funds with its general assets and use them in its business as its own. TRUSTS RESTATEMENT (Am. L. Inst., 1930) Prelim. Draft No. 1, § 15 *h*; Note (1928) 13 CORN. L. Q. 603; Note (1933) 18 CORN. L. Q. 423, 425.

Certain other deposits in the commercial department may become the subject of a trust *ex maleficio* by automatic operation of law. For example, *cf.* First National Bank of Forsyth v. Fidelity & Deposit Co., 48 F. (2d) 585 (C. C. A. 9th, 1931) (public funds deposited without the security required by law); School District No. 62 v. Schramm, 20 P. (2d) 241 (Ore. 1933) (deposit accepted when the officers of the bank knew that it was insolvent); Round Prairie Bank of Fillmore v. Downey, 64 S. W. (2d) 701 (Mo. 1933) (deposit by person known by the bank to be unauthorized or legally incompetent).

36. These are funds handled under what may more properly be regarded as agency contracts. AGENCY RESTATEMENT (Am. L. Inst. 1933) §§ 72*e*, 425*a*. With respect to such funds, however, the bank is often denominated "trustee" by the courts, and treated as such in the event of insolvency. *E.g.*, Myers v. Matusek, 98 Fla. 1126, 125 So. 360 (1929) (money invested for customer by trust department); Asheville Safe Deposit Co. v. Hood, 204 N. C. 346, 168 S. E. 524 (1933) (interest collected by trust department); Leach v. Iowa State Bank of Sioux City, 204 Iowa 497, 212 N. W. 748 (1927) (interest collected by commercial department); Parker v. Central Bank & Trust Co., 202 N. C. 230, 162 S. E. 564 (1932) (escrow in trust department); Newsom v. Acacia Mutual Life Association, 102 Fla. 567, 136 So. 389 (1931) (escrow in commercial department). HERRICK, *op. cit. supra* note 34, at 15.

37. The typical statute provides security for "all the funds held in trust": IDAHO CODE (1932) § 25-915; MONT. REV. CODE (Choate, Supp. 1927) § 6014.134; or for "the faithful performance of the duties undertaken in respect to any trust"; OHIO GEN. CODE (Page, 1926) § 710-161. Judicial interpretations are sparse; however, the Idaho statute has been held to include a trust *ex maleficio* in the commercial department, White v. Pioneer Bank & Trust Co., 50 Idaho 589, 298 Pac. 933 (1931); and a deposit of funds for a special purpose, Skinner v. Porter, 45 Idaho 530, 263 Pac. 993 (1928). Customers who have dealt with the commercial department, however, have more difficulty in establishing their right to be regarded as cestuis. Pacific State Savings & Loan Co. v. Commercial State Bank, 46 Idaho 481, 269 Pac. 86 (1928); Reichert v. State Bank of Beavertown, 262 Mich. 157, 247 N. W. 139 (1933). But even trust department customers are not always regarded as cestuis. J. G. Kuehnle Co. v. Fulton, 45 Ohio App. 386, 187 N. E. 81 (1932). Only two states confer priority which is coterminus with trust departments limits. CAL. GEN. LAWS (Deering, 1931) Act. 652, §§ 23, 27; MICH. COMP. LAWS (1929) § 11901, p. 4205. Thus, these statutes do not protect trusts *ex maleficio*. Reichert v. Fidelity Bank & Trust Co., *supra* note 5.

38. HERRICK, *op. cit. supra* note 34, at 18.

39. See note 22, *supra*.

40. Del. Laws 1933, c. 93, § 23, c. 94, § 23; FLA. COMP. LAWS (Harrison, 1927) § 6127;

reaffirming the cestui's right, long recognized in equity, to reclaim any assets specifically identified as belonging to his estate.⁴¹ If no assets are thus identifiable because the bank has mingled them with its own, contrary to law or to the express terms of the trust, or if the assets thus identified have depreciated through dereliction on the part of the bank, some states permit the cestui to recoup his loss by asserting a priority against all the assets of the bank.⁴² Security for the faithful performance of the bank's trust duties is also sought by other devices. A few jurisdictions allow trust beneficiaries a first claim upon the assets of the trust department,⁴³ which, like the savings and commercial departments, is for bookkeeping purposes treated by those states as a separate bank.⁴⁴ A number of statutes, though not treating the operations and assets of the various departments as if they were those of separately capitalized banks, nevertheless set aside the "capital stock" of the bank as special security for claims of cestuis.⁴⁵ Since capital stock is not an asset, these statutes are ex-

IOWA CODE (1931) § 9290; ME. REV. STAT. (1930) c. 57, § 75; MASS. ANN. LAWS (Michie, 1933) c. 172, § 54; 11 MO. STAT. ANN. (Vernon and West, 1932) § 5423-8; OKLA. STAT. (Harlow, 1931) § 9208; Philippine Laws 1929, Act. 3610, § 141; S. C. CIV. CODE (Michie, 1932) § 7887 (4); Vt. Pub. Acts 1933, No. 124, § 10; W. VA. CODE (1931) § 31-4-10; WYO. REV. STAT. (Courtright, 1931) § 10-403, 18th. The same result is produced by statutes giving "all funds held in trust" priority over all depositors, IDAHO CODE (1932) § 25-915; MONT. REV. CODE (Choate, Supp. 1927) § 6014.134.

41. *State v. Farmers' State Bank of Polk*, 121 Neb. 532, 237 N. W. 857 (1931).

42. Ind. Laws 1931, c. 167, § 1; Md. Laws 1933, c. 546, § 1, amending MD. ANN. CODE (Bagby, 1924) art. 11, § 48; R. I. GEN. LAWS (1923) § 3995 (to the extent of the par value of the capital stock; savings department assets exempted from this priority); D. C. CODE (1929) tit. 5, §§ 351, 372 [unless D. C. Acts. 1933, No. 434, extending the provisions of 13 STAT. 115 (1864), 12 U. S. C. § 194 (1916) to the District of Columbia, effected its repeal. This latter federal statute has been interpreted by the federal courts as forbidding the giving of any priorities. *Davis v. Elmira Savings Bank*, 161 U. S. 275 (1896). Similar provisions of state statutes, however, have not been deemed inconsistent with special protection for cestuis or savings depositors. *Cf.* CONN. GEN. STAT. (1930) § 3935, with *id.* §§ 3908, 3885; and *cf.* KY. STAT. (Carroll, 1930) § 165a-17 (c), with *id.* § 614]; W. VA. CODE (1931) § 31-4-12; possibly also CONN. GEN. STAT. (1930) § 3885 (probably limited in operation to court trusts); possibly also MONT. REV. CODE (Choate, Supp. 1927) § 6014.134. A similar statute in Idaho has been interpreted as giving no priority without tracing. *Skinner v. Porter*, *supra* note 37.

43. CAL. GEN. LAWS (Deering, 1931) Act 652, §§ 23, 27; MICH. COMP. LAWS (1929) § 12019; ORE. CODE ANN. (1930) § 22-524 (by implication only). The priority conferred carries with it a correlative disadvantage; cestuis cannot share in the assets of the other departments unless there is an overplus remaining after payment of the creditors of those departments (or unless the trust funds can be traced into those assets; see note 56, *infra*). *Cf.* *Russ Lumber Co. v. Hellman Commercial Bank*, 22 P. (2d) 234 (Cal. 1933).

44. See note 10, *supra*.

45. KY. STAT. (Carroll, 1930) § 612a; MASS. ANN. LAWS (Michie, 1932) c. 172, § 55 (priority on a par with savings depositors); OHIO ANN. CODE (Page, 1926) §§ 710-161, 710-168; PA. STAT. ANN. (Purdon, Supp. 1933) tit. 7, §§ 819-2, 819-1106, (if the words: "shall be considered as the security required by law . . . and shall be absolutely liable . . ." confer a priority); S. C. CIV. CODE (1932) § 7865.

ceedingly ambiguous. If their reference is to the assets derived from the stockholders' original contributions, the protection they afford to cestuis is largely illusory, since identification of such assets is ordinarily impossible.⁴⁶ These statutes have real meaning, however, if they are construed as giving cestuis a priority in all the assets of the bank to an amount equal to the par value of the capital stock.⁴⁷ Moreover, priority in funds realized from enforcement of the stockholders' liability frequently accompanies and lends substance to grants of "capital stock" as security for trust claimants.⁴⁸ Many jurisdictions give cestuis prior access to special guaranty funds required to be set aside or deposited with the superintendent of banks.⁴⁹

In many states in which corporate fiduciaries have been exempted from furnishing the bond exacted of individuals acting in the same capacities,⁵⁰ the dignity of the court apparently requires that funds upon which the judicial benediction has been pronounced be held especially inviolable.⁵¹ Accordingly, cestuis of court trusts are accorded a priority in special guaranty funds⁵² which must be set aside or deposited with the superintendent of banks for their ben-

46. Yet this is the interpretation adopted in Massachusetts. *In re Prudential, Cosmopolitan and Hanover Trust Cos.*, *supra* note 5.

47. This construction has been adopted in Kentucky. *Ohio Valley Bank & Trust Co. v. Pettit's Trustee*, 206 Ky. 818, 268 S. W. 535 (1925).

48. See statutes of California, Massachusetts, and Ohio, *loc. cit. supra* notes 43 and 45. *Contra*: S. C. CONST. (1895) art. 9, § 18; *Ex parte Michie*, 167 S. C. 1, 9, 165 S. E. 359, 362 (1932) (silent concurrence of supreme court in ruling by district judge on this point).

49. CAL. GEN. LAWS (Deering, 1931) Act 652, § 96 (\$50,000 to \$100,000, according to population); FLA. COMP. LAWS (1927) § 6126 (14) (\$10,000); MINN. STAT. (Mason, 1927) § 7662 (25% to 50% of capital stock); 11 MO. STAT. ANN. (1932) §§ 5424, 5425 (as directors may see fit); N. Y. BANKING LAW (1914) §§ 105, 184 (10% of capital stock); OHIO GEN. CODE (Page, 1926) §§ 710-150, 710-161; Ore. Laws 1931, c. 278, § 15 (\$50,000); Philippine Laws 1921, Act 3610, § 141 (100,000 pesos); Utah Laws 1933, c. 10, § 3 (\$10,000 to \$100,000, according to population).

50. 40 STAT. 969 (1918), 12 U. S. C. § 248 k (1926); CAL. GEN. LAWS (Deering, 1931) Act 1749, § 5; Del. Laws 1931, c. 52, § 64; 11 MO. STAT. ANN. (1932) § 5463; N. J. COMP. STAT. (1910) p. 5658; N. M. STAT. ANN. (Courtright, 1929) § 13-305; N. Y. BANKING LAW (1914) § 106; OKLA. STAT. (Harlow, 1931) § 9223; VT. PUBLIC LAWS (Proposed Revision, 1933) § 6436; WIS. STAT. (1931) § 223.03 (8). In most of these states discretion is left in the appointing court to require bond despite the general exemption.

51. Yet other jurisdictions have not thought that such exemption makes necessary special protection for cestuis of court trusts. FLA. COMP. LAWS (1927) § 6130; ILL. REV. STAT. (Smith-Hurd, 1933) c. 32, § 289; OHIO GEN. CODE (Page, 1926) § 710-161; S. C. CIV. CODE (1932) § 7865.

52. 40 STAT. 969 (1918), 12 U. S. C. § 248 k (1926) (must conform to state laws); CAL. GEN. LAWS (Deering, 1931) Act 652, § 96 (\$50,000 to \$100,000, according to population); 11 MO. STAT. ANN. (1932) § 5463 (\$200,000); N. J. COMP. STAT. (Supp. 1924) §§ 17-43b, 221-9 (5% of trust liabilities; appointments by will not protected); N. M. STAT. ANN. (Courtright, 1929) § 13-305 (\$10,000 to \$200,000, as auditor may direct); WIS. STAT. (1931) § 223.02.

efit, or even in all the assets of the bank.⁵³ While it is true that the beneficiaries of court trusts are not free to bargain with the bank for special security and so should perhaps be accorded some legislative protection,⁵⁴ many of the foregoing statutes carry such protection to an extreme incompatible with full justice to other creditors.

A cestui, court or private, whose claim is not satisfied by recourse to his own trust res and for whom sufficient special security is not available, may claim in the bank's other assets only as a general creditor,⁵⁵ unless the bank has mingled the trust res with its own funds. In the latter event, however, the cestui, if he is able to "trace" his property or its derivative into the assets in the hands of the receiver, may claim a preference equal to its value.⁵⁶ But because of the rapid flux of modern banking operations, an actual tracing of trust property is rarely possible, and rigid enforcement of the requirement would preclude the granting of many priorities.⁵⁷ Accordingly, the requirement has been tempered by the interjection of fictitious presumptions of amazing variety.⁵⁸ The most

53. Del. Laws 1931, c. 52, § 64; N. Y. BANKING LAW (1914) § 188-8; also CONN. GEN. STAT. (1930) § 3885, if the language "the assets . . . of such corporation shall be held as security . . ." is to be interpreted as conferring a priority. Louisiana has enacted that "the capital stock as paid in shall be taken . . . as security . . ." LA. GEN. STAT. (Dart, 1932) § 583. So also VT. PUB. LAWS (Proposed Revision, 1933) § 6436 (Surplus and stockholders' liability included). The assets subject to this preference, if these statutes are to be so construed, are left in doubt. Cf. notes 46 and 47, *supra*. Note that apparently no exemption from giving bond is granted in either Louisiana or Vermont. *Young v. Teutonia Bank and Trust Co.*, 134 La. 879, 64 So. 806 (1914); VT. PUB. LAWS, *supra*.

54. *Madison Trust Co. v. Carnegie Trust Co.*, 152 N. Y. Supp. 517 (App. Div. 1st Dep't, 1915). However, even if able to bargain for additional security, court trust cestuis would probably seldom do so. Moreover, in some states, banks are forbidden to give such protection. E.g., Ind. Acts. 1933, c. 40, § 179. And other states force the bank to give a bond not otherwise required, if a party in interest requests it. E.g., Md. Laws 1933, c. 546, § 1.

55. *In re Administration of trust department*, 16 Pa. D. & C. 567 (1931). Presumably on the basis of the balance of his claim. The point seems not to have been litigated where unmingled trust funds are concerned. Cf. note 67, *infra*.

56. Theoretically this is not a priority, but a recapture of specific physical property belonging to the trust estate. *Poisson v. Williams*, 15 F. (2d) 582 (E. D. N. C. 1926); *State v. Farmers' State Bank of Polk*, *supra* note 41.

57. Nevertheless, several courts refuse priority unless the tracing is accomplished in strict conformity with logic and reality. *Young v. Teutonia Bank & Trust Co.*, *supra* note 53; *First & Citizens' National Bank v. Corporation Commission*, 201 N. C. 381, 160 S. E. 360 (1931); *In re Lebanon Trust & Safe Deposit Bank's Estate*, 166 Pa. 604, 31 Atl. 334 (1895). The decisions in the first two of these cases may have been influenced by the fact that the bank was under bond to fulfill the particular trust obligations sued upon. Relaxation of the rules would merely have diminished the loss of the surety. The *First & Citizens' National Bank* case is no longer law in North Carolina, unless the rule laid down in *Flack v. Hood*, 204 N. C. 337, 168 S. E. 520 (1933), applies only to private trusts, which is unlikely. See note 65, *infra*.

58. The fallacy in tracing presumptions is discussed in a Note (1932) 30 MICH. L. REV. 441. Courts are not always conscious of their use of these presumptions, but the results which they reach can be rationalized in no other way without departing from the tracing theories to which they all pay lip service.

common and the mildest presumption is that, when the bank withdraws a portion of a particular mingled fund containing both property belonging to the bank and property belonging to a trust estate, it draws out and uses its own property first. The indulgence of this presumption gives the cestui a priority in a sum equal to the lowest amount to which the specific mingled fund was at any time reduced.⁵⁹ The next in the hierarchy of presumptions assumes that the mingled fund was never reduced to an amount less than that obtaining when the receiver took possession.⁶⁰ To reenforce these two presumptions there can be added a third, that when the bank depletes a fund containing trust property, it transfers the proceeds to its vaults or sets apart there an equivalent sum in trust.⁶¹ A fourth presumption enables the cestui to reach assets outside his own banking house, it being presumed that, when the bank depletes a fund containing trust property, it transfers the proceeds into one of its liquid cash funds, such as an account with a correspondent bank, or earmarks as a trust fund a portion of one of those accounts.⁶² And finally, it may be presumed that when the bank depleted a fund containing trust property it invested the proceeds in securities now in the hands of the receiver or in loans which have proved collectible.⁶³ If this presumption is used, bonds in portfolio

59. *Knatchbull v. Hallett*, 13 Ch. D. 696 (1880); *Bank Commissioners v. Security Trust Co.*, *supra* note 6; *Smith v. Fuller*, 86 Ohio St. 57, 99 N. E. 214 (1912); *Emigh v. Earling*, 134 Wis. 565, 115 N. W. 128 (1908).

60. Result: priority in the whole mingled fund as it came to the hands of the receiver, unless he can show that the fund at some time fell below the amount of the trust funds mingled therein; that is, the burden of evidence is on the receiver to establish that fact. *Hammons v. National Surety Co.*, 36 Ariz. 459, 287 Pac. 292 (1930); *Chapman v. First National Bank of Sipe Springs*, 275 S. W. 498 (Tex. Civ. App. 1924); *Lusk Development Co. v. Giinther*, 32 Wyo. 294, 232 Pac. 518 (1925). If the receiver succeeds in rebutting this presumption, the gap can be filled by another, *viz*: that the subsequent replenishment of the mingled fund was intended by the bank as a restoration of the trust funds. *Myers v. Matusek*, *supra* note 36. Some precedent for such a presumption exists in several other states, although it has not yet been applied to cases involving corporate fiduciaries. *United National Bank of Troy v. Weatherby*, 70 App. Div. 279, 75 N. Y. Supp. 3 (3d Dep't 1902); *Garst v. Canfield*, 44 R. I. 220, 116 Atl. 482 (1922).

61. Result: priority in the cash in vault, even though the trust moneys were originally mingled with deposits at correspondent banks or used to buy securities now dissipated. *Bank of America National Trust Association v. California Savings Bank*, 22 P. (2d) 704 (Cal. 1933) (conclusive presumption). Another form of this presumption assumes that when a bank wrongfully leaves trust money mingled with its own in the form of a balance due it from a correspondent, it sets aside an equivalent sum in its own vault in trust. *Schumacher v. Harriett*, 52 F. (2d) 817 (C. C. A. 4th, 1931); *Tucker v. Newcomb*, 67 F. (2d) 177 (C. C. A. 4th, 1933).

62. *County Commissioners v. Page*, 163 Md. 619, 164 Atl. 182 (1933); *Reichert v. United Savings Bank*, 255 Mich. 685, 239 N. W. 393 (1931); *School District No. 62 v. Schramm*, *supra* note 35 (conclusive presumption).

63. *First State Trust & Savings Co. v. Therrell*, 138 So. 733 (Fla. 1932); *Eastman v. Farmers' State Bank of Olivia*, 175 Minn. 336, 221 N. W. 236 (1928); *Porterfield v. Farmers' Exchange Bank of Gallatin*, 327 Mo. 640, 37 S. W. (2d) 936 (1931). Sometimes this presumption is indulged only if the bank had authority to invest the particular trust funds

and accounts receivable are subjected to the cestui's priority. These various presumptions thus render available to the satisfaction of trust claims all of the bank's assets which the court is willing to devote to them.⁶⁴ Courts in some states, moreover, have abandoned the maze of tracing presumptions and have awarded cestuis of wrongfully mingled trust funds an equitable lien upon the bank's entire estate in all cases; and this without the aid of legislation.⁶⁵ Massachusetts has reached this result by resorting to liberal interpretation of a segregation statute.⁶⁶ The degree of priority which cestuis of wrongfully mingled funds enjoy over commercial and savings depositors thus varies greatly from state to state depending upon the type of presumption or lien employed. Once established, however, that priority probably ranks ahead of any preference accorded commercial or savings depositors in their own assets, since trust moneys, even when identified only with the aid of presumptions, are not regarded as assets of the bank.⁶⁷

A different problem arises when a bank's intermingling of trust funds with its own is authorized, either by law or by the terms of the trust, and hence is not wrongful. Most states, ignoring the dangers inherent in permitting banks thus to act in dual capacities,⁶⁸ hold that when trust funds are legally deposited

claimed, or is rejected where the securities or accounts were acquired prior to the mingling and depletion of the trust moneys. *In re Receivership American Savings Bank of Marengo*, 210 Iowa 568, 231 N. W. 311 (1930).

64. In any given jurisdiction the same presumptions are used for the benefit of all cestuis, regardless of the nature of their trust. *First State Trust and Savings Co. v. Therrell*, *supra* note 63 (escrow, agency, private trust deed, court trust); *cf. Poisson v. Williams*, *supra* note 56 (deed of trust), with *First National Bank of Forsyth v. Fidelity & Deposit Co.*, *supra* note 35 (trust ex maleficio). But in Pennsylvania trusts ex maleficio and converted bailments enjoy the use of presumptions denied to trust department cestuis. *Mehler's Appeal*, 310 Pa. 25, 164 Atl. 619 (1932); *In re Conneautville Bank's Assigned Estate*, 280 Pa. 545, 124 Atl. 745 (1924). No good reason for this discrimination is given. *Daniel and Temin, Problem of Mingled Trust Funds in Bank Liquidations in Pennsylvania* (1933) 7 TEMP. L. Q. 160.

65. *People v. Bates*, 351 Ill. 439, 184 N. E. 597 (1933); *State v. Farmers' State Bank of Polk*, *supra* note 41; *First National Bank & Trust Co. of Asheville v. Hood*, 204 N. C. 351, 168 S. E. 528 (1933); *McKeon v. Meade County Bank*, 37 S. D. 100, 156 N. W. 795 (1916).

66. Mass. Ann. Laws (Michie, 1932) c. 172, § 54; *Morrison v. Lawrence Trust Co.*, 186 N. E. 54 (Mass. 1933). Eight other states have practically identical statutes, all *supra* note 40; yet tracing is required in at least three of them. *In re Receivership American Savings Bank of Marengo*; *Porterfield v. Farmers' Exchange Bank of Gallatin*, both *supra* note 63; *Lusk Development Co. v. Günther*, *supra* note 60.

67. *State v. Farmers' State Bank of Polk*, *supra* note 41. Sometimes priority is denied unless the cestui succeeds in tracing his res into a fund sufficiently large to pay in full all the trust moneys mingled therein. *Reichert v. Fidelity Bank and Trust Co.*, *supra* note 5; *Emigh v. Earling*, *supra* note 59. Cestuis who have failed to trace their funds share as general creditors. *Commonwealth v. Tradesmen's Trust Co. (No. 1)*, 250 Pa. 372, 95 Atl. 574 (1915); *McKeon v. Meade County Bank*, *supra* note 65. And on the basis of the balance of their claims. *Skinner v. Porter*, *supra* note 37.

68. For an appraisal of the risks attendant upon the practice of corporate self-deposit, see Note (1931) 44 HARV. L. REV. 1284; Note (1933) 31 MICH. L. REV. 532.

in the savings or commercial departments, the trust estate becomes an ordinary creditor thereof;⁶⁹ thus the bank apparently becomes trustee of its own contractual obligation.⁷⁰ But in a few states the cestuis of such funds receive the same priorities in special assets and the same tracing rights as if the trust moneys had been wrongfully mingled.⁷¹ Moreover, in many jurisdictions self-deposit by a corporate fiduciary is permitted only when securities of equal value are set aside for the prior protection of the cestuis;⁷² and some states prohibit the practice altogether.⁷³

The silence maintained by most courts on the question of the rights of general creditors in the assets of a departmental bank suggests that very few such creditors have demanded a priority in the assets of the department with which they have dealt. The statutes of a few states, however, provide that ordinary creditors of the savings, commercial or trust department may share the priority which the depositors or cestuis enjoy therein.⁷⁴ But the protection thus af-

69. *Swan v. Children's Home Society*, 67 F. (2d) 84 (C. C. A. 4th, 1933); *Bassett v. City Bank and Trust Co.*, 115 Conn. 1, 160 Atl. 60 (1932); *Florida Bank & Trust Company of West Palm Beach v. Nichols*, 135 So. 907 (Fla. 1931); *In re Louisiana Savings Bank and Safe Deposit Co.*, 40 La. Ann. 514, 4 So. 301 (1888); *Tucker v. New Hampshire Trust Co.*, 69 N. H. 187, 44 Atl. 927 (1897); *Ex parte Michie*, *supra* note 48; *Vt. Public Acts 1933*, No. 124, § 10; *Note* (1933) 39 W. VA. L. Q. 155; (1933) 17 MINN. L. REV. 318.

70. *Seutter v. Stevens*, 4 F. Supp. 877 (S. D. Miss. 1933). This seems to be the most satisfactory rationalization of these holdings, though it is contrary to orthodox trust concepts. For a less plausible explanation of the absence of priority, *cf. Worcester Bank & Trust Co. v. Nordblom*, 188 N. E. 492 (Mass. 1933) (bank entitled to use funds as own, hence no presumption that it used own funds first).

71. *Ind. Acts 1933*, c. 40, §§ 191, 192; *Flack v. Hood*, *supra* note 57; *In re Howell's Will*, 260 N. Y. Supp. 510, 511 (4th Dep't 1932) (priority the same, but procedure different); OHIO GEN. CODE (Page, Supp. 1933) § 710-165. The Ohio statute purports to give cestuis of legally self-deposited funds even more protection than other cestuis in that state, *viz.*: a prior claim upon all the assets of the bank. But it has been interpreted as conferring merely the right to trace the trust funds as if they had been wrongfully mingled. *University of Dayton v. Fulton*, 30 Ohio N. P. (N. S.) 339 (1933).

72. 40 STAT. 969 (1918), 12 U. S. C. § 248 k (1926); CAL. GEN. LAWS (Deering, 1931) Act 652, § 105; Conn. Public Acts 1931, § 517a; FLA. COMP. LAWS (Harrison, 1927) § 6128; IDAHO CODE (1932) § 25-1503; KAN. REV. STAT. (Supp. 1931) § 9-101b; MICH. COMP. LAWS (1929) § 11901, p. 4204; N. J. COMP. STAT. (Supp. 1930) § 221-7a; N. Y. BANKING LAW (1914) § 111; ORE. CODE ANN. (1930) § 22-1217; PA. STAT. ANN. (Purdon, Supp. 1933) tit. 7, § 819-1108; S. C. CIV. CODE (1932) § 7907; TEX. GEN. LAWS 1931, c. 173; Utah Laws 1933, c. 10, § 10; Va. Acts 1932, c. 352, § 1 (n), p. 692.

73. *Morrison v. Lawrence Trust Co.*, *supra* note 66; *In re Administration of Trust Department*, 9 Pa. D. & C. 702 (1927); OP. ATT'Y. GEN. (Wash. 1930) 693. Fifteen other states have segregation statutes similar to the ones upon which these holdings were based. In three of these, self-deposit as a permanent investment has been held legal. *In re Smith's Estate*, 112 Cal. App. 680, 297 Pac. 927 (1931); *Bassett v. City Bank and Trust Co.*, *supra* note 69; *McDonald v. Fulton*, 125 Ohio St. 507, 182 N. E. 504 (1932) (arose before the new statute expressly legalizing self-deposit).

74. CAL. GEN. LAWS (Deering, 1931) Act 652, §§ 23, 27; MICH. COMP. LAWS (1929) § 11901, p. 4205 (trust department creditors only); ORE. CODE ANN. (1930) § 22-524 (by

forded is double edged, for it debars the creditor from asserting any claim to any of the assets of the other departments until all the creditors of those departments have been paid in full.⁷⁵

Few of the policy considerations that appear to have motivated the granting of inter-departmental priorities in the liquidation of insolvent banks withstand analysis. There is little basis in law for the alleged belief of the average depositor that a deposit is a bailment or a trust rather than a loan.⁷⁶ The contention that special protection from loss occasioned by the bank's insolvency is necessary to induce depositors to supply the funds needed by industry is perhaps refuted by the depression phenomenon of more idle bank funds available for investment than there are safe loans in which to place them.⁷⁷ Runs upon banks will not be forestalled by providing depositors with preferences which may increase their liquidation dividends. Nor does the furtherance of commerce and industry require that protection be afforded to commercial deposits. The larger portion of such deposits are created by loans and discounts, and so are canceled upon insolvency;⁷⁸ moreover, the availability of consumer purchasing power, in part represented by the bank's other creditors, is more essential to business than is the maintenance of its own current working capital. Security accorded trust claimants merely to preserve the sanctity of fiduciary obligations disregards the fact that such security prejudices not the bank trustee, the wrongdoer, but its innocent creditors.⁷⁹

A more valid basis for the granting of preferences is afforded by the view that the loss occasioned by the bank's insolvency should be made to fall with the least severity upon the persons least able to bear it. But the many priorities

implication only); WASH. REV. STAT. (Remington, Supp. 1933) § 3244-1 (savings department creditors only). The priority thus given to trust department creditors would appear to extend to guaranty funds deposited with the secretary of banking for the benefit of the bank's "trust business." See *Russ Lumber Co. v. Hellman Commercial Bank*, *supra* note 43.

75. *Russ Lumber Co. v. Hellman Commercial Bank*, *supra* note 43.

76. The normal relation between depositor and bank is that of creditor and debtor. *In re Howell's Will*, *supra* note 71; *Pacific States Saving and Loan Co. v. Commercial State Bank*, *supra* note 37; TRUSTS RESTATEMENT (Am. L. Inst., 1930) Prelim. Draft No. 1, § 15 *h*. This is true of savings as well as commercial depositors. *Kershaw v. Kimble*, 65 F. (2d) 553 (C. C. A. 10th, 1933); *Ward v. Johnson*, 95 Ill. 215 (1880). *Contra*: *Tucker v. New Hampshire Trust Co.*, *supra* note 69 (savings deposits held by the bank in trust); *In re Cosmopolitan, Hanover and Prudential Trust Cos.*, *supra* note 5 (hybrid: half trust, half debt). There is no particular reason why the law should be remoulded to fulfill inarticulate and inherently unprovable popular expectations.

77. Cash reserves of national banks in 1929: \$819,928,000; in 1931: \$884,327,000. REP. COMPT. GEN. (1931) 1024-1025. Excess of reserves above legal requirements, Sept. 1931: \$96,326,000. *Id.* at 702.

78. *Moore and Sussman*, *supra* note 12, at 1109 *et seq.*

79. *Board of Fire & Water Commissioners v. Wilkinson*, 119 Mich. 655, 78 N. W. 893 (1899); *Townsend, Tracing Technique in Bank Preference Cases* (1933) 7 CIN. L. REV. 201, 207.

now granted in apparent recognition of this policy are at best clumsy and inexact in accomplishing its purposes. Savings deposits are not all contributed by persons of small means; a considerable proportion of them are camouflaged commercial accounts of corporations⁸⁰ or the funds of persons having other financial resources.⁸¹ Similarly, blanket protection for all cestuis frequently results in pampering Croesus;⁸² even court trust funds often consist of unearned testamentary bounties, enjoyed by persons of affluence.⁸³ The relation between loss-bearing ability and the amount of protection afforded could be made closer if there were established bases of classification more discriminating than merely whether the particular claimant is a savings depositor, commercial depositor or cestui. A favored class could be created consisting of minors deprived, by death or insanity, of one or both parents; widows or widowers supporting minor children; persons over sixty or sixty-five years of age; and charitable corporations or associations.⁸⁴ Moreover, the extent of priority could be made to vary with the size of the individual claim, it being safe to assume that ordinarily persons with larger claims will experience less distress from a larger percentage loss than will those with smaller claims. Finally, the extent of priority could be made to vary with the initial size of the trust estate⁸⁵ or the previous year's average balance of the commercial account, since these would

80. Bradford, *Social Aspects of Commercial Banking Theory* (1933) 23 AM. ECON. REV. 217. And yet persons of small means were responsible for their full share of the phenomenal increase in savings deposits from 1922 to 1928. French, *Significance of Time Deposits in the Expansion of Bank Credit 1922-1928* (1931) 39 J. POL. ECON. 759. That the great majority of savings depositors are probably persons of small means is indicated by the fact that savings deposits in state commercial banks and trust companies in 1931 amounted to only \$328 per savings depositor. REP. COMPT. GEN. (1931) 60.

81. E.g., *Ex parte Michie*, *supra* note 48 (bank president had \$8,000 in savings account); *Strauss v. United States Fidelity Co.*, 63 F. (2d) 174 (C. C. A. 4th, 1933) (\$253,000 estate had \$81,000 in savings account).

82. E.g., *Lebaudy v. Carnegie Trust Co.*, 90 Misc. 490, 154 N. Y. Supp. 900 (Sup. Ct. 1915) (claimant had formerly been cestui for \$339,000); *First National Bank & Trust Co. of Asheville v. Hood*, *supra* note 65 (cestui was a firm which had purchased a \$380,000 bond issue). The average size of private trust estates in 1931 was \$56,706. REP. COMPT. GEN. (1931) 21. Thus, even supposing that as many as five cestuis divide the proceeds of each such trust, the average cestui would appear to be less necessitous than the average savings depositor.

83. E.g., *Rottger v. First National Bank of Lafayette*, 184 N. E. 267 (Ind. App. 1933) (original size of this court trust was \$90,000); *City Bank Farmers' Trust Co. v. Taylor*, 163 Atl. 734 (R. I. 1933) (widow had a town mansion and two country estates in addition to a million dollar court trust). The average court trust in 1931 contained \$27,800. REP. COMPT. GEN. (1931) 21. Thus cestuis of court trusts seem to occupy a middle ground between savings depositors and cestuis of private trusts.

84. Such a class would be sufficiently definite to avoid the danger of provoking excessive litigation. It could be created without violating constitutional requirements of equal protection of the law, for the lines of its classification would be reasonably related to the legislative purpose. *Lindsley v. Carbonic Gas Co.* 220 U. S. 61 (1911).

85. Claims filed on behalf of trust estates should be treated as if each person beneficially interested therein were separately claiming his proportionate share.

in most cases give a positive correlation with the financial strength of the claimant. A method of distribution embodying these three bases for classification in addition to those now recognized would more adequately spread total loss in such a way as to reduce to a minimum the inconvenience and suffering inherent in the liquidation of banks.

RECOGNITION OF THE HONOR DEFENSE UNDER THE INSANITY PLEA

ONE defense in Anglo-American criminal jurisprudence which still remains largely inchoate and almost inarticulate is that of the unwritten law.¹ Despite the sympathies of private reactions toward one who kills when actuated by motives of honor, statutory law as a whole remains silent on the subject. Continental Europe adopts a somewhat charitable view toward the honor killing. In France the homicide of either the wife or the adulterer is excusable when the husband comes upon them *en flagrant délit*;² in Italy a killing for motives of honor under such circumstances is expressly made punishable only by sentence of from three to seven years, even though the murdered person be wife, sister or daughter of the avenging slayer.³ But in this country Texas alone by express statutory provision⁴ classifies the offense of the husband who kills his wife's adulterer as justifiable homicide, and then only if the latter is surprised in the act. Georgia has reached a like result by statutory interpretation.⁵

1. The decisions often take occasion to point out that the unwritten law is not recognized as a defense. See *Jackson v. State*, 91 Ga. 271, 273, 18 S. E. 298, 299 (1893); *Wehenkel v. State*, 116 Neb. 493, 495, 218 N. W. 137, 138 (1928); *Almerigi v. State*, 17 Okla. Cr. 458, 465, 188 Pac. 1094, 1096 (1920); *Kell v. State*, 6 P. (2d) 836, 837 (Okla. Cr. App. 1931).

2. CODE PÉNAL (Carpentier, 1930) art. 324.

3. IL NUOVO CODICE PENALE (1931) art. 587. Art. 132 gives the court discretionary power to increase or reduce the punishment of a particular offense within the limits fixed by the law, and Art. 62 lists among extenuating circumstances the fact of having acted for motives of special moral or social value, and having reacted when in a state of anger caused by an unjust act of another.

4. TEX. REV. PEN. CODE (Vernon, 1928) art. 1220. Under the provisions of TEX. PEN. CODE (1926) arts. 1244, 1248, repealed in 1927, adultery by the deceased with the defendant's wife, or insulting words or conduct addressed to a female relative of the killer was made adequate cause reducing the offense to manslaughter, provided that the killing occurred as soon as the fact of the illicit relation was discovered, or upon the first meeting of the parties after knowledge of the insult in question had been communicated to the killer.

5. "All other instances which stand upon the same footing of reason and justice as those enumerated shall be justifiable homicide." GA. PEN. CODE (1926) § 75. This section has been construed to include the killing of one beginning or in the act of adultery with the accused's wife. *Gibson v. State*, 161 S. E. 158 (Ga. 1931); see *Daniels v. State*, 162 Ga. 366, 369, 133 S. E. 866, 869 (1926).

But the motives prompting an honor killing are likely to win sympathy from a jury. The problem consequently becomes one of trial technique in bringing out all circumstances calculated to mitigate the punishment. In certain more or less recognized situations the admissibility of such evidence presents little difficulty. It is generally true that a husband who slays his wife's adulterer on surprising them in the unlawful act, is deemed to have been given adequate provocation, and that proof of the circumstances is competent testimony under a charge of voluntary manslaughter.⁶ The same principle applies when the killing occurs immediately upon hearing of the marital indiscretion if the offense is committed in the heat of passion engendered thereby.⁷ But when the cooling period sets in and immediate passion gives way to sober reflection the killing becomes murder.⁸ In proper circumstances, even in the absence of passion, evidence of previous marital infidelity communicated to the accused has been admitted under a plea of self-defense to show why the husband believed the adulterer to be the aggressor.⁹ Where no question of self-defense can validly be raised, however, such evidence becomes incompetent in mitigation of murder.¹⁰

It is in this situation that trial lawyers have resorted to the plea of insanity to get before a jury all circumstances of the so-called honor defense. Insanity at the time of committing a crime¹¹ is recognized as a complete defense to

6. *Logan v. State*, 155 Ala. 85, 46 So. 480 (1908); *State v. Yanz*, 74 Conn. 177, 50 Atl. 37 (1901); see *Brunson v. State*, 212 Ala. 571, 572, 103 So. 664, 665 (1925); *Garcia v. People* 64 Colo. 172, 176, 171 Pac. 754, 755 (1918); *MICHIE, HOMICIDE* (1914) § 47; 1 *WEARTON, CRIMINAL LAW* (12th ed. 1932) § 426. The mere finding of the wife in adultery is no justification where the evidence showed no heat of passion but a pre-meditated plan by the husband to kill. *People v. Gingell*, 211 Cal. 532, 296 Pac. 70 (1931); *cf. State v. Imundi*, 45 R. I. 318, 121 Atl. 215 (1923).

7. *State v. Stewart*, 278 Mo. 177, 212 S. W. 853 (1919); *Hannah v. Commonwealth*, 153 Va. 863, 149 S. E. 419 (1929); *cf. Eden v. State*, 24 Ala. App. 37, 129 So. 797 (1930) (killing of one who insulted defendant's wife); *Campbell v. Commonwealth*, 88 Ky. 402, 11 S. W. 290 (1889) (killing of husband of accused's daughter for brutality to the daughter); *McHargue v. Commonwealth*, 231 Ky. 82, 21 S. W. (2d) 115 (1929) (killing of one who had assaulted accused's brother); *State v. Flory*, 40 Wyo. 184, 276 Pac. 458 (1929) (killing by husband after learning of rape of his wife).

8. *Brunson v. State*, *supra* note 6, at 572, 103 So. at 665; *People v. Garfalo*, 207 N. Y. 141, 100 N. E. 698 (1912); *cf. Rogers v. State*, 117 Ala. 9, 22 So. 666 (1893); *McWilliams v. State*, 178 Ala. 68, 60 So. 101 (1912).

9. *Blackerby v. Commonwealth*, 200 Ky. 832, 255 S. W. 824 (1923); *cf. Boykin v. State*, 23 Ala. App. 516, 128 So. 124 (1930); *Pickett v. State*, 40 Okla. Cr. 289, 268 Pac. 732 (1928) (plea of self-defense in killing of seducer of accused's sister).

10. *Warren v. State*, 197 Ala. 313, 72 So. 624 (1916); *Lee v. State*, 16 Ala. App. 53, 75 So. 282 (1917); see *Gafford v. State*, 122 Ala. 54, 61, 25 So. 10 (1899).

11. Insanity at the time of committing the crime is to be distinguished from the entirely distinct problem of insanity at the time of trial. In the latter case the test usually advanced is simply that of ability to understand the proceedings or to make a defense. *People v. Maynard*, 347 Ill. 422, 179 N. E. 833 (1932); *State v. Murphy*, 205 Iowa 1130, 217 N. W. 225 (1928); see *People ex rel. Peabody v. Chanler*, 133 App. Div.

prosecution;¹² and the law sets up as its standard of criminal responsibility the artificial and nebulous test of ability to distinguish between right and wrong,¹³ supplemented in a minority of jurisdictions by the further test of irresistible impulse.¹⁴ Moreover, as a consequence of at least partial disregard of the highly technical aspects of the problem, the courts have insisted that the issue of insanity at the time of the crime remain a matter for jury determination,¹⁵ and have allowed a wide latitude in the admissibility of evidence.¹⁶ Non-expert witnesses may testify as to relevant facts on the question of the accused's state of mind, and may even express an opinion as to insanity.¹⁷ Eccentricities of conduct, if due to a disease of the mind,¹⁸ the enormity of

159, 162, 117 N. Y. Supp. 322, 325 (2d Dep't 1909), *aff'd*, 196 N. Y. 525, 89 N. E. 1109 (1909); Note (1926) 35 YALE L. J. 883. The test is usually fixed by statute. *Cf.* N. Y. PEN. LAW (1909) § 1120. For statutes making the issue of present insanity triable by a jury see collection in WEIHOFEN, *INSANITY AS A DEFENSE IN CRIMINAL LAW* (1933) 109-147. In some jurisdictions, however, it is a matter of the trial judge's discretion to decide what form of investigation should be pursued. *United States v. Chisholm*, 149 Fed. 284 (C. C. S. D. Ala. 1906); *Whitney v. Zerbst*, 62 F. (2d) 970 (C. C. A. 10th, 1933); *State v. Detar*, 125 Kan. 218, 263 Pac. 1071 (1928); *State v. Genna*, 163 La. 701, 112 So. 655 (1927).

12. 1 WHARTON, *op. cit. supra* note 6, § 405. Provision is usually made by statute. See N. Y. PEN. LAW (1909) § 1120, providing that an act done by a person who is an idiot, imbecile, or lunatic is not a crime. Statutes attempting to abolish the defense have been held unconstitutional. *State v. Strasburg*, 60 Wash. 106, 110 Pac. 1020 (1910); *Sinclair v. State*, 161 Miss. 142, 132 So. 581 (1931). The same rule as to the effectiveness of the insanity plea operates in other countries. See OPPENHEIMER, *CRIMINAL RESPONSIBILITY OF LUNATICS* (1909) 37-79.

13. The right and wrong test owes its modern currency to the now celebrated Opinion of the Judges, following M'Naghten's Case, 10 Clark & Fin. 200 (1843). The historical development of legal concepts of insanity are collected in 1 WHARTON AND STILLÉ, *MEDICAL JURISPRUDENCE* (5th ed. 1905) § 446 *et seq.*; GLUECK, *MENTAL DISORDER AND CRIMINAL LAW* (1925) 123-160.

14. Even though the defendant be able to distinguish the wrongfulness of his act, he is excused if he is incapable of controlling the impulse to commit it. Such is the test of irresistible impulse. See WEIHOFEN, *op. cit. supra* note 11, at 15, 16.

15. *People v. Farmer*, 194 N. Y. 251, 87 N. E. 457 (1909); *People v. Whitman*, 266 N. Y. Supp. 844 (Gen. Sess. 1933); *cf.* *Whitney v. Zerbst*, *supra* note 11, at 972; *McCully v. State*, 141 Ark. 450, 217 S. W. 453 (1920). Ordinarily evidence of insanity is introduced merely under a plea of not guilty. *Leonard v. State*, 17 Ariz. 293, 151 Pac. 947 (1915); *People v. Carlin*, 194 N. Y. 448, 87 N. E. 805 (1909); *People v. Joyce*, 233 N. Y. 61, 134 N. E. 836 (1922). See WEIHOFEN, *op. cit. supra* note 11, at 257, 258. In a minority of jurisdictions, insanity must be specially pleaded. *Bishop v. State*, 17 Ala. App. 343, 84 So. 784 (1920); *Fritz v. State*, 178 Ind. 463, 99 N. E. 727 (1912).

16. See 1 WIGMORE, *EVIDENCE* (2d ed. 1923) § 228; WEIHOFEN, *op. cit. supra* note 11, at 237-252.

17. *State v. Cross*, 72 Conn. 722, 46 Atl. 148 (1900); *People v. Phipps*, 268 Ill. 210, 109 N. E. 25 (1915); *State v. Schneider*, 158 Wash. 504, 291 Pac. 1093 (1930); *cf.* *People v. Spencer*, 179 N. Y. 408, 72 N. E. 461 (1904) (excluding expression of opinion as to insanity).

18. *Lee v. State*, 30 Okla. Cr. 14, 234 Pac. 654 (1925); *cf.* *People v. Moran*, 249 N. Y. 179, 163 N. E. 553 (1928).

the crime, the absence of motive,¹⁹ and the fact of hereditary insanity²⁰ all become evidentiary. This liberal treatment of purported evidence of lunacy becomes an apt and convenient avenue by which to present the honor defense. Evidence that might otherwise be inadmissible²¹ may be produced with the hope, largely substantiated by the decisions, that the punishment will be mitigated. Thus all the prior relationships between the adulterer and the accused's wife, communicated to the accused before the killing, can be introduced to show his state of mind.²² In most cases there is scant expectation that an acquittal will result on the basis of a finding of insanity. In all probability no question of insanity actually exists; the legal tests of responsibility would show the defendant to be sane. Nevertheless, to the jury goes the evidence for its sympathetic consideration.

One of the most striking instances of the saving function which the insanity plea has been made to perform is that of the *Remus* case.²³ While divorce proceedings were pending, the defendant killed his wife. No question of immediate provocation was involved; but by setting up a defense of insanity at the time of committing the crime, the defendant was enabled to introduce evidence of alleged marital infidelity and a conspiracy of his wife and another man to deprive him of his property.²⁴ Prosecution alienists found Remus to be sane at the time of the killing,²⁵ but a jury responsive to the evidence, and to its prejudices, declared him not guilty because of insanity.²⁶ Similar tactics were invoked in the *Massie* trial²⁷ in order to bring before the jury a description of the assault on the defendant's wife, committed long before the killing of

19. *Sagu v. State*, 94 Tex. Cr. 14, 248 S. W. 390 (1922); *cf. State v. Murphy*, 205 Iowa 1130, 217 N. W. 225 (1928) (commission of other crimes evidence of present insanity).

20. 1 WIGMORE, *op. cit. supra* note 16, § 232; *cf. Walsh v. People*, 88 N. Y. 458 (1874); *Commonwealth v. Dale*, 264 Pa. 362, 107 Atl. 743 (1919) (hereditary insanity is corroborative evidence). Prior commitment to an insane asylum is evidence of insanity in a trial for a crime subsequent to commitment, but is not conclusive. *Whitney v. Zerbst*, *supra* note 11, at 972; *People v. Prosser*, 56 Cal. App. 454, 205 Pac. 869 (1922); *cf. State v. Noel*, 102 N. J. L. 659, 133 Atl. 274 (1926).

21. See *McCandless v. Commonwealth*, 170 Ky. 301, 311, 185 S. W. 1100, 1104 (1916); *Choate v. Commonwealth*, 176 Ky. 427, 440, 195 S. W. 1080, 1086 (1917) (mayhem on person of one who had debauched defendant's wife).

22. *State v. Greene*, 152 N. C. 835, 68 S. E. 16 (1910); *State v. Herring*, 118 S. C. 386, 110 S. E. 668 (1922); *cf. State v. Russo*, 193 Iowa 992, 188 N. W. 660 (1922) (betrayal of accused by the deceased); *Abbott v. Commonwealth*, 107 Ky. 624, 55 S. W. 196 (1900) (evidence of betrayal of accused's sister); *Spencer v. State*, 69 Md. 28, 13 Atl. 809 (1888); *People v. Wood*, 126 N. Y. 249, 27 N. E. 362 (1891) (evidence that deceased had raped defendant's wife); see *Ragland v. State*, 125 Ala. 12, 28, 27 So. 983, 987 (1900) (evidence of betrayal of defendant's daughter by deceased).

23. *State v. Remus*, No. 29969 (Ohio Com. Pleas 1927).

24. Record in *State v. Remus*, *supra* note 23, vol. 2, pp. 42, 48, 52.

25. 5 *id.* at 2956, 3000, 3069.

26. Arnold, *Law Enforcement—An Attempt at Social Dissection* (1932) 42 YALE L. J. 1, 20, 22; Taft, *So This Is Justice* (1928) 56 WORLD'S WORK 95.

27. New York Times, April 15, 1932, 1, 4; *id.*, April 17th, 1, 8; *id.*, April 24th, 1, 7.

her assailant.²⁸ Here again no question of immediate provocation was present in the sense of a killing in the heat of passion, and probably no question of actual insanity. Less publicized is a recent Oklahoma case,²⁹ in which the defendant had learned of his wife's illicit relations the night before the killing. The court specifically indicated, in sustaining a conviction for manslaughter, that evidence of such relations was competent only on the issue of insanity, and that the defendant should have been convicted of murder.³⁰

Precisely what attitude should be taken toward the honor defense is largely a matter of subjective and local feeling. The average layman, as indicated by the verdicts of juries, probably favors its use even as interposed through the insanity plea. On the other hand, to the legalistic mind the recognition of honor motives, at least in the absence of statutory approval, constitutes a sanctioning of the execution of justice by vengeful individuals rather than by duly appointed authority, and encourages a general disregard for all law.³¹ A recent Illinois case³² demonstrates that private justice may make its ghastly errors. Here a father killed the alleged assailant of his seven-year-old daughter, acting only on the child's accusation, which later proved unfounded. Under pleas of self-defense and insanity, both apparently without merit from the facts, he was found guilty of manslaughter by the jury, and sentenced to a year in jail.³³

But whatever the validity of the honor defense, to label it as insanity is to confuse an already distorted legal concept.³⁴ Moreover, this usage greatly complicates the issue between law and psychiatry as to the proper method for disposing of cases involving the insane criminal. It has been widely urged that to entrust to an inexperienced jury the determination of insanity is a ludicrous means of handling an extremely difficult problem, and that the question should rather be subjected to scientific determination by a commission of experts.³⁵

28. The defendant, Massie, was found guilty of manslaughter, *id.*, April 30th, 1, 16, but his sentence was immediately commuted. *Id.*, May 5th, 1, 2.

29. *Kell v. State*, 6 P. (2d) 836 (Okla. Cr. 1931); *cf.* *January v. State*, 16 Okla. Cr. 166, 181 Pac. 514 (1919).

30. *Kell v. State*, *supra* note 29, at 837, 839.

31. See Roberts, *The Unwritten Law* (1922) 10 KY. L. J. 45; Note (1927) 71 SOL. J. 257.

32. *People v. Garippo*, 321 Ill. 157, 151 N. E. 584 (1926).

33. *Ibid.* The conviction of manslaughter was reversed on other grounds, and the case remanded for further proceedings.

34. For the conflict between law and psychiatry as to the proper conception of insanity, see generally CHURCH AND PETERSON, *NERVOUS AND MENTAL DISEASES* (9th ed. 1921) 687-689; ELLIOT, *CONFLICTING PENAL THEORIES* (1931) 22-31; GOODHEART, *ESSAYS IN JURISPRUDENCE* (1931) 46-49; JELIFFE AND WHITE, *DISEASES OF THE NERVOUS SYSTEM* (2d ed. 1917) 884; 1 WHARTON AND STILLÉ, *op. cit. supra* note 13, § 574; Glueck, *Psychiatric Examination of Persons Accused of Crime* (1927) 36 YALE L. J. 632.

35. CARDOZO, *LAW AND LITERATURE* (1931) 79-109; ENSOR, *COURTS AND JUDGES* (1933) 89, 90; ILLINOIS CRIME SURVEY (1929) 737-748; *Report of the Institute of Criminal Law and Criminology* (1919) 10 J. CRIM. L. 186; WHITE, *INSANITY AND THE CRIMINAL LAW* (1923) 171, 271; *cf.* SINGER AND KROHN, *INSANITY AND LAW* (1924) 411-414; Glueck, *Principles of Rational Penal Code* (1928) 41 HARV. L. REV. 453.

But while such statutory action³⁶ should undoubtedly be supported as a method of segregating actual psychopathic cases for expert treatment, and thus bringing the law more nearly into accord with developments in the field of psychiatry,³⁷ its effect would probably be to rule out the honor defense; for the honor motive would clearly find little place in the psychiatrist's conception of insanity. If, therefore, it is deemed desirable to retain the honor defense, the legislation which has been suggested would, paradoxically, involve a questionable step unless there were combined with it a definite statutory sanction of the defense in the substantive criminal law.³⁸ It would seem that the proper solution of the problem lies in such legislative acceptance of the unwritten law. An open and avowed recognition of the emotional factor in criminal trials may give rise to moral and legalistic qualms, but the result would at least be an honest treatment of what is now tolerated through more devious means.

36. In Louisiana a statute which attempted to make conclusive the report of a lunacy commission on the question of an accused's insanity has been held unconstitutional, *State v. Lange*, 168 La. 958, 123 So. 639 (1929). The Louisiana statute now designates the personnel of a permanent lunacy commission, which shall act immediately on the filing of an insanity plea. A finding of insanity by the commission is conclusive; a finding of sanity results in a trial of the case by a jury. LA. CODE CRIM. PROC. (1932) art. 268-270.

37. The role of the expert has been broadened somewhat by statutory provision, in recognition of the advances of psychiatry. In Massachusetts examination by the state department of mental diseases is required of all persons under indictment for capital offenses, and the preparation of a report is made available to both the defense and prosecution. MASS. ANN. LAWS (1932) v. 4, c. 123, § 100. In Wisconsin the trial judge is empowered by statute in criminal cases to appoint experts to examine the accused, and no defense experts may examine until the prior examination is completed. WIS. STAT. (1931) § 357.12. The act was held constitutional in *Jessner v. State*, 202 Wis. 184, 231 N. W. 634 (1930). In Colorado a defendant pleading insanity must be committed to a state hospital for observation for one month. Colo. Laws 1927, c. 90, § 2. The role of the insanity commission in New York is indicated in *People v. Whitman*, *supra* note 15, at 847, 848, in which reference to the commission is held discretionary with the trial court. The commission's report, moreover, is held to be only evidentiary; the ultimate determination of the issue rests with the jury. *Cf. People v. McElvaine*, 125 N. Y. 596, 26 N. E. 929 (1891). Provision for the appointment of the commission is made in N. Y. CODE CRIM. PROC. (1882) § 658. It is to be composed of three disinterested persons, and no qualifications are imposed as to their competency or expert training.

38. A somewhat analogous provision exists in Illinois where by statute under a plea of guilty the court is directed to examine witnesses as to the "aggravation and mitigation of the offense." ILL. REV. STAT. (Smith-Hurd, 1933) c. 38, § 732. It was under this section that the defense in the *Loeb-Leopold* case was made. See (1924) 15 J. CRIM. L. 347-394.

THE TENNESSEE VALLEY AUTHORITY ACT

ALTERNATING turbulent¹ with calm stretches, the Tennessee River system flows for twelve hundred miles from the Appalachians to the Ohio River, touching seven states and forming a valley the size of England.² Within its watershed, which encompasses over 40,000 square miles, lie cities,³ fertile tobacco lands, worn-out farms,⁴ both dense and devastated forests,⁵ and mineral-laden mountains. Vast and almost untouched deposits of coal, iron ore and limestone are to be found within easy reach of the river; and there is also much copper, zinc, marble, bauxite, lead and manganese.⁶ Despite the thirty-seven miles of shoals,⁷ known as Muscle Shoals, the river serves as an artery of commerce for the valley; 2,000,000 tons of freight valued at \$50,000,000 a year move

1. The average annual flood damage to the Tennessee Valley amounts to \$1,780,000; the 1926 flood caused damages estimated at \$2,650,000. *Tennessee Valley Authority* (1933) 8 FORTUNE 88; TENNESSEE RIVER AND TRIBUTARIES, LETTER FROM SECRETARY OF WAR, H. R. Doc. No. 328, 71st Cong., 2d Sess. (1930) 2.

2. The tributaries of the Tennessee River start in western Virginia and North Carolina, northern Georgia, and southeastern Kentucky. The main body of the river begins near Knoxville, Tennessee, and flows southward across northern Alabama and northeastern Mississippi; then northward through Tennessee and Kentucky; it empties into the Ohio River shortly before that river, in turn, flows into the Mississippi. For a description of the Tennessee Valley, see 26 AMERICANA ENCYCLOPEDIA (1927) 432; *Tennessee Valley Authority*, *supra* note 1; Kimble, *The Tennessee Valley Project* (1933) 9 J. OF LAND & PUB. UTIL. ECON. 327.

3. The leading cities are: Chattanooga, Tennessee, pop. 120,000; Knoxville, Tennessee, pop. 106,000; Asheville, Tennessee, pop. 50,000; Paducah, Kentucky, pop. 34,000. The total population of the valley is 2,000,000, one-half of whom are engaged in farming. TENNESSEE RIVER AND TRIBUTARIES, *supra* note 1, at 1, 8.

4. As a result of unscientific farming, exhausting the soil fertility, and of uncontrolled soil erosion, much of the farm lands of the mountainous sections, especially, have become virtually waste regions. The typical valley farming family, consequently, has a low standard of living, surviving on as little as \$100 cash a year. Lilienthal, *A New National Conservation Policy*, T. V. A. Press Release, July 18, 1933, at 2-3; T. V. A. Press Releases, Oct. 13 and 21, 1933; *Tennessee Valley Authority*, *supra* note 1, at 88. The principal farm products are livestock, corn, tobacco, wheat, oats, peanuts, hay, cotton and sweet potatoes. TENNESSEE RIVER AND TRIBUTARIES, *supra* note 1, at 8.

5. While dense forests, especially of chestnut, oak and oak pine, still exist in portions of the Tennessee Mountains, unrestrained lumber operations have deforested portions of the valley. The problems of soil erosion and floods are intimately connected with the destruction of these forests. Lilienthal, *supra* note 4, at 2-4; *Tennessee Valley Authority*, *supra* note 1, at 88.

6. TENNESSEE RIVER AND TRIBUTARIES, *supra* note 1, at 8. Popular periodicals visualize the Tennessee Valley as a potential American Ruhr. *Tennessee Valley Authority*, *supra* note 1, at 83, 84, 86.

7. MUSCLE SHOALS COMMISSION, MUSCLE SHOALS, A PLAN FOR THE USE OF THE UNITED STATES PROPERTIES ON THE TENNESSEE RIVER BY PRIVATE INDUSTRY FOR THE MANUFACTURE OF FERTILIZERS AND OTHER USEFUL PRODUCTS (1931) 95.

on its upper and lower reaches.⁸ And even the rapids are of inestimable value as potential sites⁹ for the generation of hydro-electric power.¹⁰

During the past century government officials, engineers and promoters have visualized the development of the Tennessee River. Various schemes for turning it to uses of navigation, power development, nitrate production and national defense were proposed,¹¹ but none were successfully carried into effect. One of the most recent plans was that projected in 1916 when President Wilson, acting under the authority of the National Defense Act,¹² selected Muscle Shoals as the best site for the extraction of nitrogen from the atmosphere; more than \$100,000,000 was expended on its development.¹³ Before this project was completed, however, the war ended, and there followed a protracted, acrimo-

8. However, due to uncontrolled water flow, shallows and other obstructions, only 12,000 tons of freight pass Muscle Shoals each year. *T. V. A. Press Release*, July 16, 1933. It is estimated that through river developments traffic by 1950 will increase to 17,800,000 tons, with an annual saving of \$22,800,000 in freight rates over rail transportation. *TENNESSEE RIVER AND TRIBUTARIES*, *supra* note 1, at 11.

9. In addition to Muscle Shoals in Alabama, important shoals or rapids exist on the upper tributaries, notably on the Clinch River (the site for the new Cove Creek Dam), the Holston, Broad, Little Tennessee, and Hiwassee rivers. The Elk, Buffalo, and Duck rivers, which flow into the lower part of the Tennessee, also contain valuable power sites.

10. The flow of the river at Muscle Shoals at some seasons of the year is sufficient to produce more than 1,000,000 horse power while at its minimum flow the horsepower is less than 100,000. It is expected that the construction of dams and storage reservoirs, especially at Cove Creek, will equalize the flow of the river for power generation and navigation purposes. *REPORT OF SENATE COMMITTEE ON AGRICULTURE AND FORESTRY ACCOMPANYING S. J. RES. 227, 67th Cong., 2d Sess. (1922) 6.*

11. The official history of the Tennessee River project dates back to 1824 when John C. Calhoun, as Secretary of War, recommended a survey of Muscle Shoals as highly important for the improvement of transportation in the United States. During the next decade, as a result of a federal grant to Alabama, that state undertook the construction of a canal system around the shoals; but insufficient appropriations for an adequate system and for maintenance caused the canal to fall into ruins. After the Civil War congressional interest in the navigability of the Tennessee River revived, but no effective action was taken because Congress never approved the engineering plans necessary for a successful transportation system. At the beginning of the present century the potentialities of Muscle Shoals for power generation were recognized and bids were received from hydro-electric power companies; but prior to the World War Congress took no action. *MUSCLE SHOALS COMMISSION, op. cit. supra* note 7, at 95-7; *Address of Congressman Mitchell* (1933) 77 *CONG. REC.* 2256; Kimble, *supra* note 2, at 325.

12. 39 *STAT.* 215 (1916). In the passage of this act, Congress recognized the fact that nitrates, employable for human destruction, are also a necessary, but expensive, ingredient of successful agricultural fertilizers and authorized the peace-time use of these plants for the manufacture of fertilizers.

13. Among the improvements were Wilson Dam and two nitrate plants, No. 1 being an experimental plant and No. 2 being a large cyanamid process plant. Several hydro-electric and steam power units were also built, and also Waco Quarry, which supplied the large quantities of limestone needed for the cyanamid process. *REPORT OF SENATE COMMITTEE ON AGRICULTURE AND FORESTRY, supra* note 10, at 3.

nious dispute over the disposition of the property.¹⁴ Contending that the government should not compete with private business, that the government could not profitably generate and sell electric power, that private utilities were satisfactorily supplying the needs of the valley markets, and that its nitrate plants were already obsolete, the congressional supporters of the Coolidge and Hoover administrations favored the lease or sale of Muscle Shoals to private utility or fertilizer companies.¹⁵ On the other hand, the progressives in Congress, led by Senator Norris, insisted that only through public operation could the maximum use of this project and distribution of its social benefits be achieved.¹⁶ After a decade of legislative stalemates¹⁷ Congress has finally, at the instance of President Roosevelt,¹⁸ enacted a measure which contemplates a comprehensive development of the entire Tennessee Valley under governmental auspices.

The Tennessee Valley Authority Act¹⁹ enumerates as its objectives the im-

14. Power companies, fertilizer corporations, and Henry Ford offered to purchase or lease portions of the Muscle Shoals facilities. For descriptions of these bids and discussions of their merits, see REPORT OF SENATE COMMITTEE ON AGRICULTURE AND FORESTRY, *supra* note 10, at 12-36; MINORITY REPORT OF SENATE COMMITTEE ON AGRICULTURE AND FORESTRY TO ACCOMPANY S. J. RES. 227, 67th Cong., 2d Sess. (1922); HEARINGS BEFORE SENATE COMMITTEE ON AGRICULTURE AND FORESTRY ON MUSCLE SHOALS, 67th Cong., 2d Sess. (1922); HEARINGS BEFORE U. S. CONGRESS JOINT COMMITTEE ON LEASING OF MUSCLE SHOALS, 69th Cong., 1st Sess. (1926); HEARINGS BEFORE SENATE COMMITTEE ON AGRICULTURE AND FORESTRY ON THE DISPOSITION OF MUSCLE SHOALS, 70th Cong., 1st Sess. (1928).

15. *Veto message of President Hoover* (1931) 74 CONG. REC. 7046; MINORITY REPORT OF SENATE COMMITTEE ON AGRICULTURE AND FORESTRY, *supra* note 14; MUSCLE SHOALS COMMISSION, *op. cit. supra* note 7; *Congressional debates on the Tennessee Valley Authority Act*, especially addresses by Congressman Goss (1933) 77 CONG. REC. 2251, 3591, Congressman Treadway (1933) 77 CONG. REC. 2189, Congressman Eaton (1933) 77 CONG. REC. 2195.

16. REPORT OF SENATE COMMITTEE ON AGRICULTURE AND FORESTRY, *supra* note 10, at 28-36; HEARINGS BEFORE THE SENATE COMMITTEE ON AGRICULTURE AND FORESTRY ON S. J. RES. 15, *To Create Muscle Shoals Corporation of the United States*, 72d Cong., 1st Sess. (1932); HEARINGS BEFORE SENATE COMMITTEE ON AGRICULTURE AND FORESTRY ON S. J. 49, *Muscle Shoals*, 71st Cong., 1st Sess. (1929); *Congressional debates on the Tennessee Valley Authority Act*, especially addresses by Congressman Blanton (1933) 11 CONG. REC. 3597, Congressman Hill (1933) 77 CONG. REC. 2186, Congressman Almon (1933) 77 CONG. REC. 2194, Congressman Taylor (1933) 77 CONG. REC. 2197, Congressman Turner (1933) 77 CONG. REC. 2248.

17. In 1928 Congress passed the Norris bill favoring government operation of Muscle Shoals, but President Coolidge killed it by a pocket veto. Again in 1931 Congress passed a similar measure and President Hoover vetoed it. At the latter's suggestion in his veto message, the states of Tennessee and Alabama created a joint commission to study plans for the disposal of Muscle Shoals; this body recommended the further development of the Tennessee River by the federal government, but favored private rather than public operation of the power and fertilizer units. MUSCLE SHOALS COMMISSION, *supra* note 7. The accuracy of this report was questioned by Senator Norris. HEARINGS BEFORE THE SENATE COMMITTEE ON AGRICULTURE AND FORESTRY ON S. J. RES. 15, *supra* note 16, at 103.

18. (1933) 77 CONG. REC. 1423.

19. P. L. No. 32, 73d Cong., 1st Sess. (1933).

provement of navigation, control of floods, withdrawal from cultivation and reforestation of the valley's marginal lands, agricultural and industrial development of the district, and the furtherance of the national defense. The preamble of the statute, possibly in anticipation of a legal dispute as to whether the legislation comes within the constitutional grant of powers to the federal government, conspicuously omits all mention of hydro-electric power. Its importance, however, is apparent; government generation of large quantities of low cost electric power will benefit the region and will act as a measuring rod for evaluating the cost of power sold by private utilities.²⁰ But behind these purposes lies an even more significant objective. President Roosevelt and his administrators visualize this measure as the first conscious, national effort at regional planning.²¹ It is hoped that through the distribution of power to the rural and back-hill country of the Tennessee Valley the life of its inhabitants, long considered economically and socially backward, may be advanced.²² The formation of government towns, the construction of dwellings, the laying out of parks, roads and recreation facilities are planned, not merely as necessary incidentals of a large public construction project, but as experimental examples to other American communities.²³

For the accomplishment of these general purposes, the Act establishes a Tennessee Valley Authority or Corporation of which the United States is sole stockholder; its three directors are appointed by the President with senatorial approval for over-lapping nine-year terms. The Corporation is given generous specific powers and may, in addition thereto, exercise whatever other powers are necessary for the execution of its delegated functions. The statute provides in general terms that the Corporation may be sued; and judicial precedent²⁴

20. Lilienthal, *A Five-Point Program for the Electrification of America*, T. V. A. Press Release, Nov. 11, 1933, at 2-3; *Statement by Lilienthal*, T. V. A. Press Release, Sept. 28, 1933, at 5; Morgan, *Planning in the Tennessee Valley* (1933) 38 CUR. HIST. 663.

21. Lilienthal, *supra* note 4, at 6; Morgan, *supra* note 20, at 665; *Statement by Morgan*, T. V. A. Press Release, Aug. 31, 1933, at 8-19. Recently, the federal government has announced plans for regional planning and development in other parts of the United States. N. Y. Herald-Tribune, Feb. 15, 1934, at 1.

22. Lilienthal, *The Electrification of the American Home*, T. V. A. Press Release, Jan. 20, 1934; Lilienthal, *supra* note 4, at 4. To further the use of electric equipment, the Tennessee Valley Corporation has created the Electric Home and Farm Authority. T. V. A. Press Release, Dec. 20, 1933.

23. Draper, *The T. V. A. Freeway*, T. V. A. Press Release, Jan. 21, 1934; Draper, *A T. V. A. House of Three Rooms*, T. V. A. Press Release, Jan. 22, 1934; Draper, *The New T. V. A. Town of Norris, Tennessee*, T. V. A. Press Release, Nov. 24, 1933; Draper, *Housing the Workers at Norris Dam*, T. V. A. Press Release, Nov. 25, 1933.

24. *Sloan Shipyards Corp. v. United States Shipping Board Emergency Fleet Corp.* 258 U. S. 549 (1922). The Court held that although the United States cannot be sued in tort, an agent or instrumentality of the government which has wrongfully seized private property may be held liable for its unlawful acts. Borchard, *Government Liability in Tort* (1924) 34 YALE L. J. 1, at 22; McGuire, *Government by Corporations* (1928) 14 VA. L. REV. 182; Note (1932) 32 COL. L. REV. 881; Note (1924) 8 MINN. L. REV. 427

as well as the Act's legislative history²⁵ indicate clearly that it will be liable for both tort and contract claims.

The government-owned corporation as a device for administering public projects is of recent origin; the Federal Land Banks, created in 1916,²⁶ were the first important instance. Shortly thereafter, to meet the exigencies of the War, a number of others were established.²⁷ Between the Armistice and the stock market collapse of 1929, only two such corporations were formed, the Federal Intermediate Credit Banks²⁸ and the Inland Waterways Corporation.²⁹ But in the last four years, the device has again become prominent.³⁰ The advantages of the government corporation are that it enjoys the flexibility of private business and is free from political interference through congressional budgeting.³¹ It must be recognized, however, that a project like the Tennessee Valley Authority is open to sabotage by a hostile Chief Executive. For although Congress has given the directors a continuing tenure of office and has provided for dismissals by a concurrent resolution of both houses of the legislature, the unqualified holding in *Myers v. United States*³² in favor of Presidential removals is dangerous to the Authority's corporate independence.

25. The House bill placed no limitation whatever upon the suability of the Corporation, while the Senate amendment limited the suability solely to suits for the enforcement of contracts and the defense of property. The conference committee accepted the House provision. (1933) 77 CONG. REC. 3560, 3564. Such changes in bill drafts and reports of committees are important sources for the judicial determination of legislative intent. Landis, *A Note on Statutory Interpretation* (1930) 43 HARV. L. REV. 886.

26. 39 STAT. 362 (1916), 12 U. S. C. § 671 (1926). The stock of these banks, when first set up, was primarily owned by the federal government; but gradually stock ownership has, in accordance with the legislative plan, been shifted to agricultural credit co-operatives. For a discussion of this use of the government-owned corporation, see VAN DOREN, *GOVERNMENT OWNED CORPORATIONS* (1926) 16-42.

27. The principal war-time government corporations were the Emergency Fleet Corporation, of which the United States Shipping Board was the majority stockholder, 39 STAT. 728 (1916), 46 U. S. C. § 810 (1926); the United States Grain Corporation, created by Executive Order No. 2681 on the authority of the Food Control Act of 1917, 40 STAT. 276 (1917); the War Finance Corporation, 40 STAT. 506 (1918); the United States Housing Corporation, 40 STAT. 550 (1918); and the United States Spruce Production Corporation, 40 STAT. 888 (1918). For a discussion of these corporations, see VAN DOREN, *op. cit. supra* note 26, at 43-197, 242-255.

28. 42 STAT. 1454 (1923), 12 U. S. C. § 1061 (1926); VAN DOREN, *op. cit. supra* note 26, at 198-205.

29. 42 STAT. 1454 (1932), 12 U. S. C. § 151 (1926); VAN DOREN, *op. cit. supra* note 26, at 206-226; BEARD AND BEARD, *THE AMERICAN LEVIATHAN* (1930) 380-1.

30. Reconstruction Finance Corporation, 47 STAT. 5 (1932), 15 U. S. C. Supp. VI § 601 (1932); Federal Deposit Guarantee Corporation, Banking Act of 1933, P. L. No. 89, § 8, 73d Cong., 1st Sess. (1933); Home Owners' Loan Corporation, P. L. No. 64, § 4, 73d Cong., 1st Sess. (1933).

31. VAN DOREN, *op. cit. supra* note 26, at 258-79.

32. 272 U. S. 52 (1926). A few months ago President Roosevelt removed Commissioner Humphrey from the Federal Trade Commission without a hearing or issuance of charges, although the members of that body have, by statute, long, over-lapping tenures of office. N. Y. Times, Oct. 8, 1933, at 24.

Unlike the N. I. R. A.,³³ the Tennessee Valley Authority Act involves no attempt at voluntary or compulsory cooperation of private capital with the national administration; on the contrary the government is here undisguisedly going into business in competition with private enterprise, and should the venture prove successful, it will be at the expense of those groups that profit through corporate financing and dividends. Attacks upon this legislation may consequently be anticipated from a variety of sources. Though aimed at the heart of the measure, they will probably be launched at particular aspects deemed vulnerable. A few of such possible suits will be examined.

For the effective execution of the plan, the Corporation is empowered to exercise the right of eminent domain,³⁴ this power being especially important in the construction of Cove Creek, or Norris, dam³⁵ and for the acquisition or erection of a transmission system.³⁶ An initial attack may accordingly come from dissatisfied property owners, including power companies holding condemned transmission units. They may tie up the work by lengthy judicial reviews of the fairness of the prices paid in the condemnation proceedings,³⁷ or they may contest the constitutional right of the federal government to exercise eminent domain on the ground that the project does not fall within its delegated powers. The Constitution, it is true, does not grant the federal government authority to generate or distribute electricity. But the power aspects of the project are so intimately related with the rest of the measure that they probably will not be segregated by the courts for condemnation. The generation of hydro-electric power is essential for nitrate production, which, in turn, is indispensable to the national defense; and the disposal of surplus power not so used to possible consumers can be proved to be necessary to avoid unconscionable waste.³⁸ Furthermore, a major function of the new dams will be to equalize the flow of the river for navigation and for flood control.³⁹ And though flood control is not an activity specifically delegated by the Constitution, it has long been recognized as an incident of congressional power over navigation.⁴⁰

33. P. L. No. 90, 73d Cong., 1st Sess. (1933).

34. The provision of the Fifth Amendment that private property shall not be taken for public use without just compensation is the constitutional recognition of the power of eminent domain.

35. In order to equalize the flow of the river at Muscle Shoals, both for the facilitation of navigation through canals and for the more efficient development of power potentialities, the Corporation is authorized to construct several additional dams on the upper portion of the Tennessee River and its tributaries, notably at Cove Creek. Kimble, *supra* note 2, at 336, 337.

36. To facilitate its power business, the Corporation may purchase, lease, or condemn existing transmission lines or construct its own.

37. The condemnation procedure is set forth in the Act.

38. For statistical data on the waste of power and nitrate through the non-operation of Muscle Shoals, see (1933) 77 CONG. REC. 2271-2.

39. The reforestation, essential to check the flood waters from the hills, will likewise prevent the filling of the storage reservoirs with washed-away soil. See Morgan, *The Tennessee Valley Authority* (1934) 38 SCI. MO. 64; Lilienthal, *supra* note 4, at 4.

40. BEARD AND BEARD, *op. cit. supra* note 29, at 600-1. The Federal Water Power Act

If the Corporation survives the obstacle of the Tenth Amendment,⁴¹ it is unlikely to meet further difficulties in its exercise of eminent domain. Ample precedent exists for resisting attack on the ground that the activities contemplated are not a "public purpose."⁴² Eminent domain has been exercised by the federal government to obtain sites for public buildings,⁴³ to construct highways for interstate commerce,⁴⁴ to establish parks and memorials,⁴⁵ and to prevent gold hoarding.⁴⁶ State use of this power has been sustained for the transportation of oil by pipe lines,⁴⁷ the transmission of messages by telephone and telegraph,⁴⁸ the irrigation of arid lands,⁴⁹ and land drainage.⁵⁰ Nor can the right of the Corporation to exercise the power of eminent domain be defeated by a hostile state government; ever since the decision in *Kohl v. United States*,⁵¹ it has been recognized that the federal government may take private lands within the territory of a state without securing its consent. And since both Congress and the state legislatures may legally delegate this power to private corporations⁵² there should be little doubt but that it may be delegated to a government-owned corporation.

of 1920 similarly provided for federal supervision of private hydro-electric projects and for possible federal acquisition of such properties under the guise of regulating navigation. 41 STAT. 1065 (1920), 41 STAT. 1353 (1921), 16 U. S. C. §§ 797-809 (1926).

41. "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

42. Eminent domain may not be exercised for a private purpose even though compensation is paid. *Missouri Pacific Ry. Co. v. Nebraska*, 164 U. S. 403 (1896); *Chicago, Burlington & Quincy Rr. Co. v. Chicago*, 166 U. S. 226 (1897); 1 NICHOLS, EMINENT DOMAIN (1917) §§ 37, 39; 1 LEWIS, EMINENT DOMAIN (1909) § 315. But the courts have been liberal in their interpretations of "public purpose." See Bell, *Public Purpose in Taxation and Eminent Domain* (1931) 18 VA. L. REV. 50; 1 LEWIS, *op. cit. supra*, § 315.

43. *Kohl v. United States*, 91 U. S. 367 (1875).

44. *United States v. Jones*, 109 U. S. 513 (1883).

45. *Shoemaker v. United States*, 147 U. S. 282 (1893); *United States v. Gettysburg Electric Ry. Co.*, 160 U. S. 668 (1896).

46. *United States v. Campbell*, 5 F. Supp. 156 (S. D. N. Y. 1933), noted in (1934) 43 YALE L. J. 497.

47. *West Virginia Transportation Co. v. Volcanic Oil and Coal Co.*, 5 W. Va. 382 (1872).

48. *Pierce v. Drew*, 136 Mass. 75 (1883); *American Telephone and Telegraph Co. v. St. Louis, Iron Mountain & Southern Ry. Co.*, 202 Mo. 656 (1907).

49. *Fallbrook Irrigation District v. Bradley*, 164 U. S. 112 (1896).

50. *Sweet v. Rechel*, 159 U. S. 380 (1895). Although the question whether a taking of property by the T. V. A. is for a "public purpose" is one for judicial determination, *cf. Hairston v. Danville and Western Ry. Co.*, 208 U. S. 598, 606 (1908), after an affirmative decision on that issue, the necessity for the condemnation of any specific property and the extent to which this power shall be exercised are to be decided by its directors alone, *cf. Shoemaker v. United States*, *supra* note 45, at 298; *United States v. Gettysburg Electric Ry. Co.*, *supra* note 45, at 685.

51. *Supra* note 43. Accord: *California v. Central Pacific Rr. Co.*, 127 U. S. 1, 39 (1888); *Cherokee Nation v. Southern Kansas Rr. Co.*, 135 U. S. 641, 656 (1890); *Luxton v. North River Bridge Co.*, 153 U. S. 525 (1894).

52. *California v. Central Pacific Rr. Co.*, *supra* note 51; *Luxton v. North River*

A second group of antagonists will be the large fertilizer companies.⁵³ The Corporation is instructed to modernize nitrate plant No. 2⁵⁴ and is empowered to engage in experimentation with and production of commercial fertilizers. In order that the expenses of this production may be low, the Authority may use, upon payment of reasonable compensation, any necessary private processes patented by the United States Patent Office. This provision applies not merely to patents issued subsequently to the passage of the Act, but also to the very important modifications already made on the Haber process of nitrate extraction from the atmosphere.⁵⁵ Government patents are privileges extended to inventors, and processes patented after the adoption of the Act may consequently be subjected to the restriction in favor of the government-owned corporation. Serious problems will arise, however, when use is made of already patented nitrate processes. On behalf of the fertilizer companies it may be argued that the United States government has no more right than any private person to use a patented invention without a license from the patentee.⁵⁶ Since the patentee acquires by his patent a legal monopoly and since the government, if it is permitted to share in the patent, may succeed in underselling his assignees and driving them from the market, the statutory stipulation of compensation is, from the viewpoint of private enterprise, an inadequate remedy. An analogy may be made to the *Dartmouth College* case⁵⁷ by considering a patent privilege similar to a corporate charter and a unilateral alteration in the terms of that monopoly comparable to an impairment of the obligation of a contract.⁵⁸ But the arguments and precedents in favor of this statutory provision are stronger than those against its validity.

Bridge Co., *supra* note 51; Strickley v. Highland Boy Gold Mining Co., 200 U. S. 527 (1906); Union Lime Co. v. Chicago & Northwestern Ry. Co., 233 U. S. 211 (1914); Mt. Vernon-Woodberry Cotton Duck Co. v. Alabama Interstate Power Co., 240 U. S. 30 (1916); 1 LEWIS, *op. cit. supra* note 42, § 253.

53. The National Fertilizer Association attempted to discourage the government from entering into the fertilizer business by contending that a surplus of nitrate already exists and that the Muscle Shoals equipment is hopelessly antiquated. See HEARINGS BEFORE SENATE COMMITTEE ON AGRICULTURE AND FORESTRY ON S. J. RES. 15, *supra* note 16, at 125-152.

54. The Corporation is required to keep it in readiness for possible war use.

55. For a brief description of the various processes in extracting nitrogen from the atmosphere, see HEARINGS BEFORE THE SENATE COMMITTEE ON AGRICULTURE AND FORESTRY ON S. J. RES. 15, *supra* note 16, at 56; MUSCLE SHOALS COMMISSION, *op. cit. supra* note 7, at 49.

56. See *United States v. Burns*, 12 Wall. 246, 252 (U. S. 1870); *Cammeyer v. Newton*, 94 U. S. 225, 235 (1876); *James v. Campbell*, 104 U. S. 356, 357 (1881); *Hollister v. Benedict & Burnham Manufacturing Co.*, 113 U. S. 59, 67 (1885); *United States v. Palmer*, 128 U. S. 262, 270 (1888); *Belknap v. Schild*, 161 U. S. 10, 16 (1896).

57. 4 Wheat. 518 (U. S. 1819).

58. "A patent is a contract between the government or public on one side, and the patentee upon the other side, and the same rules apply to the interpretation and construction of a patent as are applied to the construction of a contract." FISHBURNE, *THE PATENT APPLICATION* (1933) 3.

All types of property,⁵⁹ including choses in action,⁶⁰ corporate franchises⁶¹ and even patents,⁶² may be entirely condemned under the power of eminent domain; a fortiori it would seem that the Corporation may take over partial use as well as complete ownership of necessary patents if compensation is paid. This conclusion is substantiated by the governmental practice, sanctioned during the World War, of manufacturing and using patented equipment without the patentees' consent and relegating the owners to suits for damages against the government.⁶³

The Tennessee Valley power program may likewise instigate vigorous opposition from the electric operating and holding companies in that district. The Corporation is authorized to sell its surplus electric energy, but is instructed to give preference to municipal and consumers' cooperative power systems over private utilities. Moreover, among the accounting provisions of the statute there is a section that may prove embarrassing to the utilities. The Authority is to allocate the costs of its construction work among the items of national defense, navigation, flood control, agricultural development and power generation. This attempt at cost accounting will serve as a determinant of the public power costs against which to measure private utility rates throughout the country.⁶⁴ And the manipulation of these joint costs may result in a lower figure for power than private enterprise would wish. Already the Corporation has entered into a power contract with a Mississippi town at rates much below those the community formerly paid.⁶⁵ In their struggle for survival the valley electric companies may contend that such destruction of their business by government price-cutting is as much a deprivation of property without due process of law⁶⁶ as is a prohibition against the continuance of business,⁶⁷

59. See Cormack, *Legal Concepts in Cases of Eminent Domain* (1931) 41 YALE L. J. 221; 2 LEWIS, *op. cit. supra* note 42, § 411; 1 NICHOLS, *op. cit. supra* note 42, § 20.

60. 2 LEWIS, *op. cit. supra* note 42, § 413.

61. Long Island Water Supply Co. v. Brooklyn, 166 U. S. 685 (1897); Offield v. New York, New Haven and Hartford Rr. Co., 203 U. S. 372 (1906); Kennebec Water District v. Waterville, 96 Me. 234, 242, 52 Atl. 774, 778 (1902); 2 LEWIS, *op. cit. supra* note 42, § 413.

62. 1 NICHOLS, *op. cit. supra* note 42, § 20; Fenning, *Patent Infringement by the Government* (1928) 37 YALE L. J. 773.

63. The Naval Appropriation Act of 1918 provided that "Whenever an invention described in and covered by a patent of the United States shall hereafter be used or manufactured by or for the United States without license of the owner thereof, or lawful right to use or manufacture the same, such owner's remedy shall be by suit against the United States in the Court of Claims for the recovery of his reasonable and entire compensation for such use and manufacture." 40 STAT. 705 (1918).

64. See note 20, *supra*.

65. It is estimated that the city, Tupelo, Mississippi, will save 60% of its previous power costs. *T. V. A. Press Releases*, Nov. 7 and 15, 1933.

66. This same argument can also be made by the fertilizer companies, if the nitrate division of the Tennessee Valley Corporation succeeds in producing cheap commercial fertilizers.

67. New State Ice Co. v. Liebman, 285 U. S. 262 (1932).

its encumbrance by arbitrary regulations,⁶⁸ or the fixing of confiscatory rates.⁶⁹ The precise issue has never been presented to the Supreme Court, but the previous expansions of government into business fields have unavoidably resulted in losses to private capital. The creation of the parcel post system in 1912 virtually drove the express companies out of the business of carrying small packages; the establishment of the postal savings system in 1910 cut into the profits of banks; the barge lines of the Inland Waterways Corporation have impinged upon the freight business of the mid-western railroads; prior to the sale of its fleet, the United States Shipping Board was in active competition with privately owned merchant marines;⁷⁰ and, in the absence of state statutes to the contrary, municipalities have been allowed to compete with private electric and street railway companies, frequently to the financial loss of the latter.⁷¹ The nearest approach to the Tennessee Valley project that has been subjected to judicial scrutiny was the Non-Partisan League program in North Dakota after the World War, in which the state government undertook the operation of grain elevators, utilities, a bank, a mortgage company, and a home building association. The legal attack upon this program came in the form of questioning the public purpose behind the taxation instituted to finance these projects.⁷² In *Green v. Frasier*⁷³ the Supreme Court sustained the legislation and declared that when a government undertakes to exert its taxing power and the issue of the validity of its action is raised every presumption must be indulged in its favor.

Still another source of attack upon the Act is likely to be found in the state governments of the valley themselves. While the legislation is aimed at the economic development of the region, presumably to the states' great benefit, nevertheless a recrudescence of the states' rights argument, stimulated by the necessities for new state tax revenues, by the jealousies of local politicians and, above all, by the propaganda of the influential groups hostile to the project,

68. *Tyson v. Banton*, 273 U. S. 418 (1927); *Ribnik v. McBride*, 277 U. S. 350 (1928); *Williams v. Standard Oil Co.*, 278 U. S. 235 (1929).

69. *Ottinger v. Consolidated Gas Co.*, 272 U. S. 576 (1926); *Railroad Commission v. Los Angeles Ry. Corp.*, 280 U. S. 145 (1929); Barnes, *Federal Courts and State Regulation of Utility Rates* (1934) 43 YALE L. J. 417.

70. BEARD AND BEARD, *op. cit. supra* note 29, at 380, 387, 389, 425.

71. See, e. g., *City of Seymour v. Texas Electric Service Co.*, 66 F. (2d) 814 (C. C. A. 5th, 1933); *Economic Gas Co. v. City of Los Angeles*, 168 Cal. 448, 143 Pac. 717 (1914); *Mapleton v. Iowa Public Service Co.*, 209 Iowa 400, 223 N. W. 476 (1929); *City of Farmersville v. Texas-Louisiana Power Co.*, 55 S. W. (2d) 540 (Tex. Civ. App. 1933); *Logan City v. Public Utilities Commission of Utah*, 72 Utah 536, 271 Pac. 961 (1928).

72. Since federal taxes are not usually allocated to special purposes but are levied to cover the entire costs of government, and since the federal courts frown upon tax-payers' injunction actions against the Treasury's payment of appropriations, this procedure is not available for attacking the constitutionality of the Tennessee Valley Authority Act. *Frothingham v. Mellon*, 262 U. S. 447 (1923).

73. 253 U. S. 233 (1920); see McAllister, *Public Purpose in Taxation* (1930) 18 CALIF. L. REV. 137, 241; Kneir, *Municipal Functions and the Law of Public Purpose* (1928) 76 U. OF PA. L. REV. 824; Bell, *supra* note 42.

may incite a serious conflict between the state and federal governments. Although the Act provides for payments from the sale of power to Tennessee and Alabama,⁷⁴ undoubtedly as a substitute for taxes,⁷⁵ the valley state governments or their local subdivisions may attempt to levy assessments against the property or income of the Corporation. It is conceivable that justifiable cause of grievance may arise. The Authority, by over-weighing the navigation and defense items in its analysis of joint costs, may set a low rate for electricity and thus reduce the income of Tennessee and Alabama from the project; and this low price may indirectly reduce their tax returns on the profits and property values of the private power corporations. The flooding of large areas by new storage reservoirs and the removal of submarginal lands from cultivation may also seriously reduce the scope of the taxing power of several county and rural governments. Even prior to the creation of the Tennessee Valley Authority Alabama attempted to tax the United States on the surplus power sold at Muscle Shoals by bringing suit in the Court of Claims. In that case the Supreme Court declared that the statutory jurisdiction of the Court of Claims did not extend to tax claims and dismissed the suit without any discussion of its merits.⁷⁶ But the present Act has removed this procedural difficulty of collecting a tax levy against the Corporation by providing that it may be sued. This remedy may prove of little value, however; for if the Supreme Court follows the precedents established in connection with war-time government-owned corporations, the property of the Authority that is used for public purposes will be free from local tax burdens.⁷⁷ On the other hand, so extensive an invasion of government into economic fields with the concomitant reduction of the potential tax revenues of the other units of the federal hierarchy may induce the Court to reexamine the century-old problem of taxation of government instrumentalities.⁷⁸

State interference with the Corporation's activities through their power to regulate public utilities may prove an even more serious legal obstacle. Can the Tennessee Valley Corporation enter the utility field without a certificate of public convenience and necessity from the state public service commissions or in disregard of exclusive franchises granted to private companies? The

74. Each state is to receive 5% of the gross proceeds received from the sale of power generated in that state.

75. HEARINGS BEFORE SENATE COMMITTEE ON AGRICULTURE AND FORESTRY ON S. J. RES. 49, *supra* note 16, at 7-8; *Address by Congressman Hill*, (1933) 77 CONG. REC. 3598. On the value of such evidence for the judicial determination of legislative intent, see Landis, *supra* note 25.

76. *Alabama v. United States*, 282 U. S. 502 (1931).

77. In *King County v. United States Shipping Board Emergency Fleet Corporation*, 282 Fed. 950 (C. C. A. 9th, 1922), the Circuit Court of Appeals invalidated a local levy upon the corporation's shipyard property; and in *United States Spruce Production Corporation v. Lincoln County*, 285 Fed. 388 (D. Ore. 1922), a federal District Court declared that the land, forests and other property belonging to that government body are free from tax assessments.

78. See Boudin, *The Taxation of Governmental Instrumentalities* (1933-34) 22 GEO. L. J. 1, 254.

Act requires that the wholesale purchasers of the Corporation's power must resell at rates fixed by the Authority's directors; and already a retail rate schedule much below that charged by the private utilities has been announced.⁷⁹ Can the state commission through their general power to fix minimum rates to prevent destructive competition⁸⁰ counteract the Corporation's policy of a wide distribution of cheap power? The statute further anticipates the establishment of municipal and consumers' cooperative power companies as outlets for the Corporation's surplus power. May the states deny to these organizations franchises or certificates of public convenience and necessity? If the Corporation is free from such state utility regulations and if it succeeds in winning the electric market of the valley, the state governments of that part of the country will be driven from the recognized field of power regulation. On behalf of the states the precedent of *Smythe v. Ames*⁸¹ may be used; there the Supreme Court held that the federal incorporation of a railroad company did not free it from state rate fixing.⁸² On the other hand, state interference with the Corporation's rates or power program, especially where there is undue influence by private utility interests on the local commissions, would effectively destroy a vital portion of the whole project. In the last analysis, the solution of this novel issue of federal-state relations will rest upon the Court's reaction to the government's entrance into the power business.

79. For the schedule of rates fixed by the Corporation, see *T. V. A. Press Releases*, Sept. 14 and 15, 1933.

80. Comment (1933) 43 *YALE L. J.* 114. In *re Tennessee Electric Power Co.*, 2 P. U. R. (N. S.) 4 (Tennessee Rr. & Pub. Util. Comm. 1934), a local power company sought the state commission's approval of a contract made with the Tennessee Valley Authority, whereby the two organizations divided the state power market between themselves; the former was to buy power from the latter and agreed to resell at the scheduled rates of the Authority. The commission approved the contract, but reserved the right to alter the rate in the future, adding: "The approval of this Commission to this contract . . . is not to be construed as an agreement to approve and maintain these rates in effect for the length of the contract, but the Commission is of the opinion that the rates and service of every public utility in Tennessee are subject to the regulation of the Commission, and this Commission cannot be deprived and denuded of its powers and duties . . . by the contract of the parties establishing rates . . ." *Id.* at 7.

81. 169 U. S. 466 (1898).

82. The Union Pacific Railroad Company claimed exemption from the Nebraska statute on the ground that it was created by Congress for the accomplishment of the national purposes of securing the safe and speedy transportation of the mails, troops, munitions of war and public stores of the United States. *Id.* at 519-22.