St. John's Law Review

Volume 15, April 1941, Number 2 Article 9

The Pledging of Bank Assets to Secure Deposits: Intra or Ultra Vires?

Bernard Schiff

sory; the corporation being compelled to buy only if it has a surplus, a fund which it controls. That in turn led to the conclusion that the contract was a nullity lacking mutuality of obligation. However, assuming that which many doubt, *i.e.*, that mutuality is essential, this promise is no more illusory than many analogous promises which serve as consideration. We have for example infants' promises, promises within the statute of frauds, promises of the government, promises to meet requirements, and promises to buy output. All such promises bind the promisee although the promisor may have an option not to perform and yet escape liability Although specific performance was properly denied in the *Topken* case for a lack of equity on the plaintiff's side it becomes important to determine the soundness of the *dicta* as the case of *Greater New York Carpet House* v *Herschmann* is viewed. The holding in this case is also correct, but the *dicta* in the *Topken* case is affirmed by the Appellate Division and an incorrect inference of consideration is drawn so that the correct result is reached nevertheless. As matters stand there are two correct decisions based on two doubtful opinions.

LEO SALON.

THE PLEDGING OF BANK ASSETS TO SECURE DEPOSITS. INTRA OR ULTRA VIRES?

The insolvent condition of many banks in the last decade has served, more frequently, to bring to the attention of the courts a transaction whereby a bank hypothecates its liquid assets to secure a deposit. There is a contrariety of opinion as to whether such an act is within the authority of a bank, due mainly to the difference of economic views in applying statutes and formulating policies. It remains to determine the particular instances when a bank may pledge its assets to secure deposits and, in the absence of authority, the effect of such *ultra vires* acts. Any discussion of the powers of banks must of necessity be divided into separate treatments of national banks and state banks. In view of the problem involved, there must be a further distinction made between public and private deposits.

State Banks

In the absence of statute, expressly stating whether a bank has the right to pledge its assets, it becomes a question of public policy in the determination of the *intra* or *ultra vires* quality of such act.[1]

---

[1] Hellawell v. Hempstead, 10 F Supp. 771 (S. D. N. Y. 1935), Luikart v. Aurora, 125 Neb. 263, 249 N. W 590 (1933).

If one maintains that there is nothing inherently wrong in a banking corporation's assets being pledged to secure a depositor, then the act is *intra vires* as being within the purview of the banking business. This is the earlier and more authoritative view held by a majority of the courts.[2] If, on the other hand, it is felt that the rights of general depositors and stockholders are jeopardized by the hypothecation, then the act is *ultra vires*. The later decisions of a minority of the states adopt the latter.[3]

The majority has often sustained its decisions by an approach which makes use of the sovereign's right to priority The king, by his prerogative, was preferred in the payment of debts,[4] and the state, as successor to the sovereign power, became endowed with such right of priority [5] From this it was argued that the result can be no more inimical to the interest of the depositor upon the bank's insolvency, if the state deposit is secured by a pledge of assets. Such rule clearly is not an equitable one, but is based on grounds of expediency and public welfare.[6] But this analogy fails where an at-

---

[2] William v. Hall, 30 Ariz. 581, 249 Pac. 755 (1926), McFerson v. National Surety Co., 72 Colo. 482, 212 Pac. 489 (1923), First American Bank and Trust Co. v. Palm Beach, 96 Fla. 247, 117 So. 900 (1928), Interstate National Bank v. Ferguson, 48 Kan. 732, 30 Pac. 237 (1892), Ward v. Johnson, 95 Ill. 215 (1880), Schornick v. Butler, 205 Ind. 304, 185 N. E. 111 (1933), Richards v. Osceola Bank, 79 Iowa 707, 45 N. W 294 (1890), Citizen's State Bank v. First National Bank, 98 Kan. 109, 157 Pac. 392 (1916), U. S. Fidelity and G. Co. v. Bassfield, 148 Miss. 109, 114 So. 26 (1927), Consol. School Dist. v. Citizen's Savings Bank, 223 Mo. App. 940, 21 S. W (2d) 781 (1929), Ainsworth v. Kruger, 80 Mont. 468, 260 Pac. 1055 (1927), Melaven v. Hunker, 35 N. M. 408, 299 Pac. 1075 (1931), Page Trust Co. v. Rose, 192 N. C. 673, 135 S. E. 795 (1926), Mays v. Board of Comm'rs, 164 Okla. 231, 23 P. (2d) 664 (1933), Ahl v. Rhoads, 84 Pa. 319 (1877), Cameron v. Christy, 286 Pa. 405, 133 Atl. 551 (1926), Grigsby v. Peoples Bank, 158 Tenn. 182, 11 S. W (2d) 673 (1928).

[3] Maryland Casualty Co. v. Rainwater, 173 Ark. 84, 291 S. W 1003 (1927), Arkansas-Louisiana Highway Improvement Dist. v. Taylor, 177 Ark. 440, 6 S. W (2d) 533 (1928), Wood v. Imperial Irrigation Dist., 216 Cal. 748, 17 P (2d) 128 (1932), Commercial Bank and Trust Co. v. Citizens Trust and Guaranty Co., 153 Ky. 566, 156 S. W 160 (1916), Albers v. Continental Illinois Bank and Trust Co., 296 Ill. App. 596, 17 N. E. (2d) 67 (1938), Farmer's and Merchant's State Bank v. Consol. School Dist., 174 Minn. 286, 219 N. W 163 (1928), State Bank of Commerce v. Stone, 261 N. Y. 175, 184 N. E. 750 (1933), City of Mt. Vernon v. Mt. Vernon Trust Co., 245 App. Div. 748, 281 N. Y. Supp. 1008 (2d Dept. 1935), *rev'd,* 270 N. Y. 400, 1 N. E. (2d) 825 (1936), Divide County v. Baird, 55 N. D. 45, 212 N. W 236 (1927), Foster v. Longview, 26 S. W (2d) 1059 (Tex. 1930), *rev'g,* 11 S. W (2d) 217 (Tex. Civ. App. 1928), Austin v. Lamar County, 11 S. W (2d) 553 (Tex. Civ. App. 1928), *rev'd,* 26 S. W (2d) 1062 (Tex. 1930).

[4] Giles v. Grover, 9 Bing. 128, 139 Eng. Rep. 563 (1832), *In re* Henley & Co., L. R. 9 Ch. Div. 469, 39 L. T. (N. S.) 53 (1878).

[5] *In re* Carnegie Trust Co., 206 N. Y. 390, 99 N. E. 1096 (1912). *Contra:* Central Trust Co. v. Third Ave. Ry., 186 Fed. 291 (C. C. A. 2d, 1911), Smith v. Arnold, 165 Ky. 214, 176 S. W 983 (1915), Shields v. Thomas, 71 Miss. 260, 42 Am. St. Rep. 458 (1893).

[6] "The right is therefore one that is adapted to the circumstances, conditions, and necessities of the people because essential to sustain the public burdens and discharge the public debts, and unless some provision of statute can be found which clearly evinces a legislative intent to abandon or waive this preference

tempt is made to extend it to political subdivisions of the state, for the state's priority is not transferable.[7]

Most often advanced, in favor of the pledging of assets, is the argument that a deposit is, as a matter of law, a loan.[8] A bank may borrow money and pledge its assets to secure the loan.[9] Since a deposit is legally a loan, and a loan may be secured, then a bank may lawfully hypothecate its assets to secure a deposit.[10] Such reasoning is faulty A deposit and a loan are similar only in result—they both give rise to a debtor and creditor relationship.[11] A loan is sought when the financial stability of the institution is threatened and is necessary for its preservation. Deposits, on the contrary, are invited by a semblance of responsibility and sound structure and, while necessary in the aggregate, do not separately, as an incident of the banking business, necessitate the pledging of property to which general depositors look for their security [12] In a case which declared invalid pledges other than those expressly authorized by statute it was said.[13]

Large deposits signify health and large borrowings banking disease. Springing from opposite causes, the two by their existence signify opposite conditions—deposits the normal and borrowings the abnormal. Moreover, the antithesis holds to the end, for the withdrawal of a deposit is a loss, whereas the payment

---

right of the state it is the duty of the courts to preserve rather than to defeat it." U. S. Fidelity & Guaranty Co. v. Bramwell, 108 Ore. 261, 217 Pac. 332, 335 (1923), 3 ZOLLMAN, BANKS AND BANKING (perm. ed.) 521.

[7] Aetna Casualty and Surety Co. v. Bramwell, 12 F (2d) 307 (D. Ore. 1926), *In re* Northern Bank of New York, 212 N. Y. 608, 106 N. E. 749 (1914).

[8] 1 MORSE, BANKS AND BANKING (6th ed. 1928) 665; Note (1932) 41 YALE L. J. 1076.

[9] Merrill v. National Bank of Jacksonville, 173 U. S. 131, 19 Sup. Ct. 360 (1899), Auten v. U. S. Nat. Bank of N. Y., 174 U. S. 125, 19 Sup. Ct. 628 (1899), Schumacher v. Eastern Bank & Trust Co., 52 F (2d) 925 (C. C. A. 4th, 1931), Curtis v. Leavitt, 15 N. Y. 9 (1857).

[10] William v. Hall, 30 Ariz. 581, 249 Pac. 755 (1926), Page Trust Co. v. Rose, 192 N. C. 673, 135 S. E. 795 (1926); Grigsby v. People's Bank, 158 Tenn. 182, 11 S. W (2d) 673 (1928).

[11] "A deposit was originally a delivery of property for gratuitous safekeeping, title to which remained in the depositor. The word is now used to designate a certain type of loan, *i.e.*, to a bank. * * *

"Though general deposits, whether on time or demand or evidenced by a certificate of deposit, are sometimes referred to as loans, they are neither loans nor bailments, strictly speaking, but are transactions peculiar in the banking business, which the courts recognize and deal with according to commercial usage and understanding.

"The main purpose of a loan is investment. The main purpose of a deposit is safe-keeping. A deposit clearly is not a loan pure and simple." 3 ZOLLMAN, BANKS AND BANKING (perm. ed.) § 3154.

[12] Texas and Pacific Ry. v. Pottorff, 291 U. S. 245, 256 (fn. 8), 54 Sup. Ct. 416 (1934) ("the pledge reduces the fund of quick assets available to meet unusual demands without any assurance that the deposit will be used to replenish this fund.").

[13] Farmer's and Merchant's State Bank v. Consol. School Dist., 174 Minn. 286, 291, 219 N. W 163, 165 (1928).

of a loan is a gain. Deposits continued and increased evidence banking success, whereas borrowings continued and increased portend failure.

It is also urged that the amount of the pledged assets is replaced by the deposit,[14] so that in any event the general depositors are deprived of nothing. It is more than probable, however, that the depositor will demand more security than the amount of the deposit. While the bank may carefully watch the relation between the pledged assets and the balance of the account, it is very likely that the deposit may dwindle and the pledge allowed to remain static in the hope that the depositor will replace the difference. The result is that a substantial part of the bank's property is removed from lucrative commerce. More important is the fact that the depositor will take advantage of the pledge only after the bank becomes insolvent.[15] It is indeed difficult to deny that when the bank is in sound financial condition, the pledge is faultless as of the time of the deposit. But when, after the bank has become insolvent, the depositor demands return of his deposit in full it is impractical to observe the transaction theoretically as one isolated in time.[16]

Although it would seem that the alleged identity between a loan and a deposit, which has persuaded some courts to uphold a pledge,[17] should apply equally as well to private deposits, the majority of the later decisions are to the effect that a bank may not pledge its assets to secure private deposits.[18] The cases, in which the analogy (between a loan and a deposit) supports the decision upholding the pledge, involve public deposits and the courts were therefore con-

---

14 Page Trust Co. v. Rose, 192 N. C. 673, 135 S. E. 795 (1926).

15 See note 12, *supra.*

16 *Ibid.* From an examination of the report in *City of Mt. Vernon* v. *Mt. Vernon Trust Co.*, 245 App. Div. 748, 281 N. Y. Supp. 1008 (2d Dept. 1935), *rev'd*, 270 N. Y. 400, 1 N. E. (2d) 825 (1936), one may become aware of the inequity resulting from such transaction. There was a deposit of public funds of something more than a million dollars. The defendant bank had pledged as security $800,000 of its assets. After the bank holiday the defendant reopened and paid out 10% of the deposits. After reorganization defendant paid 55% of the deposits. Thus plaintiff had received $650,000 of its deposit, leaving a balance of $450,000 secured by assets to the value of $800,000. Plaintiff city sold the pledged assets and credited the defendant with the proceeds of the sale. "This action is now brought for the payment of $103,000 in cash, being the approximate difference between the amount of the original deposit owed to the city less the credit from the sale of the pledged securities, and the payment in cash of ten per cent at the time of the restricted opening and fifty-five per cent at the time of the unrestricted opening" (p. 406). It is evident that the plaintiff realized only $250,000 from the forced sale of the assets valued at $800,000, and the bank is still liable for the balance.

17 See note 10, *supra.*

18 Wood v. Imperial Irrigation Dist., 216 Cal. 748, 17 P (2d) 128 (1932), People v. Wiersema State Bank, 361 Ill. 75, 197 N. E. 537 (1935), State Bank of Commerce v. Stone, 261 N. Y. 175, 184 N. E. 750 (1933), Fulton v. Dean, 47 Ohio App. 558, 192 N. E. 278 (1934), (1927) 22 ILL. L. REV. 449; Note (1931) 79 U. OF PA. L. REV. 608, Note (1932) 41 YALE L. J. 1076; and see generally cases cited in note 3, *supra.*

cerned with the protection of public funds.[19] An eminent authority on banks and banking states that, because a bank has the power to give security for public deposits or for a loan, it does not mean that a power exists to secure its private depositors "directly or indirectly, by estoppel or otherwise" [20]

Most of the cases whether in support of one view or the other, involve statutes which provide for the exaction of some type of security for various public funds.[21] Such statutes help but little, for they leave open the question of the validity of pledges not specifically mentioned, and the judicial construction will be colored by public policy [22] If the depositor is to be protected and such pledge is a threat to his general security, then the bank must adhere to the letter of the statute, [23] if such acts are not considered adverse to the best interests of banking institutions, then such statute shows a legislative intent to secure all public moneys.[24] In favor of pledging assets for public deposits it is said [25]

> Securing public deposits is on a different plane than securing private deposits. There is soliciting among banks to secure public deposits, and security follows as a matter of course. The knowledge of this practice does not interfere with the business of the bank. General depositors are not influenced by such knowledge. It is a distinction to a bank to be a public depository. Public funds are added to the assets of the bank and are to the advantage of general depositors. When a bank is sound it is good business judgment to pledge its collateral to secure public funds instead of paying a surety company for bonds written for the same purpose.

On the other hand it is contended that the power to pledge "permits an unfair preference seriously prejudicial to the rights of the mass of depositors whom the course of legislation has been con-

---

[19] See note 10, *supra;* Note (1932) 41 YALE L. J. 1076.

[20] 5 ZOLLMAN, BANKS AND BANKING (perm. ed.) 271. "If a bank had power to pledge its assets to secure the deposit of one private depositor without the knowledge of its other depositors, the mere possibility of the exercise of this favoritism and preferences would breed distrust in depositors and lessen their number." (276).

[21] Representative are those enacted by the New York Legislature. STATE FINANCE LAW § 105 (N. Y. Laws 1940, c. 593), COUNTY LAW § 45 (Amend. L. 1938, c. 655, § 1), N. Y. CITY CHARTER § 421 (N. Y. Laws, 1934, c. 867). These impose upon the named officer the duty of exacting, of the selected depositary, a surety bond or in lieu thereof certain designated securities. With respect to the city charters enacted by the legislature, there is *dicta* in *New Rochelle Trust Co.* v. *White,* 283 N. Y. 223, 28 N. E. (2d) 387 (1940), to the effect that they are sufficient authorization for state banks to pledge assets to secure public funds of such cities.

[22] See note 1, *supra.*

[23] Rider v. State, 170 Okla. 630, 41 P (2d) 484 (1935), State Bank of Commerce v. Stone, 261 N. Y. 175, 184 N. E. 750 (1933), Comm. Bank and Trust Co. v. Citizen's Trust and Guaranty Co., 153 Ky. 566, 156 S. W 160 (1916), Divide County v. Baird, 55 N. D. 45, 212 N. W 236 (1927).

[24] Temple v. McKay, 172 S. C. 305, 174 S. E. 23 (1934).

[25] 5 ZOLLMAN, BANKS AND BANKING (perm. ed.) 265.

sistently designed to protect." [26] Then too, the bank invites the public to deposit moneys upon a misrepresentation of its financial condition, its published periodical statements contain no mention of these secret withdrawals of its assets.[27] In *Commercial Bank and Trust Co.* v. *Citizens Trust and Guaranty Co.* the court decided that it would be against public policy to imply from statute, authorizing the pledge of assets to secure certain public funds, the general power to so pledge. The prime motive was to prevent the infliction of financial loss upon depositors and stockholders, insofar as such practice, in case of insolvency, would enable the bank to favor the few at the expense of the many [28]

In New York whatever doubt there may have been, as to the authority of banks to pledge their assets to secure public moneys, has been removed by a declaration of legislative intent.[29] This intent has been construed as recognizing that a bank has not the authority to pledge its assets to secure deposits of any kind, public or private, which are not expressly provided for in the statutes.[30] In *New Rochelle Trust Co.* v. *White*,[31] the question was whether a local city law, requiring a city officer to exact security from a depositary of city funds, bestowed authority on a bank to give such security The Court of Appeals answered the question in the negative and, citing *State Bank of Commerce* v *Stone,* reiterated what it had there said—in the absence of statutory authority a bank may not pledge its assets to secure a deposit; the statutes empower the banks to hypothecate their securities for deposits of public moneys only in *some cases.*

The United States Supreme Court reached the same conclusion in *City of Yonkers* v *Downey*,[32] decided before the *New Rochelle Trust Co.* case, but citing *State Bank of Commerce* v *Stone* [33] and *City of Mt. Vernon* v *Mt. Vernon Trust Co.*,[34] relied on by the Court of Appeals. In the *Yonkers* case the district court denied the

---

[26] Note (1931) 79 U. OF PA. L. REV. 608, Note (1934) 6 ROCKY MT. L. REV. 246.

[27] State Bank of Commerce v. Stone, 261 N. Y. 175, 184 N. E. 750 (1933).

[28] 153 Ky. 566, 156 S. W 160 (1913), followed in City of Louisville v. Fidelity and Columbia Trust Co., 54 S. W (2d) 40 (Ky. 1932).

[29] State Bank of Commerce v. Stone, 261 N. Y. 175, 184 N. E. 750 (1933), see note 21, *supra.*

[30] Downey v. City of Yonkers, 23 F Supp. 1018 (S. D. N. Y. 1938), *aff'd,* 106 F (2d) 69 (C. C. A. 2d, 1939), *certiorari granted sub nom* City of Yonkers v. Downey, 308 U. S. 547, 60 Sup. Ct. 298 (1940), *aff'd,* 309 U. S. 590, 60 Sup. Ct. 796 (1940), New Rochelle Trust Co. v. White, 283 N. Y. 223, 28 N. E. (2d) 387 (1940). But see Hellawell v. Town of Hempstead, 10 F Supp. 771 (E. D. N. Y. 1935), Matter of Broderick, 140 Misc. 861, 252 N. Y. Supp. 68 (1931), Matter of Bank of Spencerport, 143 Misc. 196, 255 N. Y. Supp. 482 (1932).

[31] 283 N. Y. 223, 28 N. E. (2d) 387 (1940), *rev'g,* 258 App. Div. 400, 17 N. Y. S. (2d) 375 (3d Dept. 1940).

[32] 309 U. S. 590, 60 Sup. Ct. 796 (1940).

[33] 261 N. Y. 175, 184 N. E. 750 (1933).

[34] 270 N. Y. 400, 1 N. E. (2d) 825 (1936).

contention of the defendant city that the power of state banks to pledge its assets to secure public moneys is established by practice, public policy, court decisions and statutes. It found that the statutes deny rather than affirm the existence of public policy in favor of the general right to make such pledge.[35] *Hellawell* v *Town of Hempstead, Matter of Broderick* and *Matter of Bank of Spencerport*[36] were cited as holding that New York's public policy authorized banks to pledge assets to secure public deposits, but it was said that such decisions must give way to a decision of the Court of Appeals which had spoken in *State Bank of Commerce* v *Stone*.[37]

Thus the expressions of the Court of Appeals and the United States Supreme Court are to the effect that a bank does not have the authority to hypothecate its assets to secure a depositor, the exception being specific authorization by statute which is strictly construed.

National Banks

In contradistinction to state banks, national banks are not subject to the sovereignty of the state,[38] and all their powers must be gleaned from federal statutes.[39] The Banking Act of 1864[40] authorized the giving of security for federal funds deposited by the Secretary of the Treasury But nowhere in the statute could be found mention of the pledging of assets to secure deposits. The Act and all of the amendments to it, prior to 1930, specifically designated the funds for which the public officer must demand a pledge of assets.[41] It was the duty imposed upon the officer which authorized the bank to make the pledge.[42] Plainly then, there was no statutory authority for the banks to pledge security to a private depositor, and the United States Supreme Court has consistently refused to recognize such power based on anything but statutory authority[43]

---

[35] Downey v. City of Yonkers, 23 F Supp. 1018 (S. D. N. Y. 1938). "As was said by the Attorney General of the State of New York in opinion under date of June 15, 1933, in referring to these various provisions: 'It will be noted that all of the provisions thus far herein cited concern themselves with public moneys * * * this might lead to the conclusion that in the absence of a special act therefor banks may not give security for deposits made by public officers and agents.'" (1021).

[36] See note 30, *supra*.

[37] See note 29, *supra*.

[38] Davis v. Elmira Savings Bank, 161 U. S. 275, 16 Sup. Ct. 506 (1896).

[39] Cook County Nat. Bank v. United States, 107 U. S. 445, 2 Sup. Ct. 561 (1882), California Bank v. Kennedy, 167 U. S. 362, 17 Sup. Ct. 831 (1897), First Nat. Bank v. Missouri, 263 U. S. 640, 44 Sup. Ct. 213 (1934), Faircloth v. Atlantic City, 16 F Supp. 705 (D. N. J. 1936).

[40] 13 STAT. 101, 12 U. S. C. A. § 90 (1864).

[41] Texas and Pac. Ry. v. Pottorff, 291 U. S. 245, 257, 54 Sup. Ct. 416 (1933).

[42] O'Connor v. Rhodes, 65 App. D. C. 21, 79 F (2d) 146 (1935), *aff'd*, 297 U. S. 383, 56 Sup. Ct. 517 (1936).

[43] Texas and Pacific Ry. v. Pottorff, 291 U. S. 245, 54 Sup. Ct. 416 (1933), City of Marion v. Sneeden, 291 U. S. 262, 54 Sup. Ct. 421 (1933).

Prior to 1930 a national bank could not legally pledge its assets to secure deposits by a state or a political subdivision thereof.[44] Not until 1930 did the general expression "public money" enter into the Act.[45] Then it was confined to monies of a state or political subdivision thereof. The purpose of the amendment was to equalize opportunities between state and national banks in the same state.[46] The latter could now pledge assets to secure deposits of state monies where the state bank was so "authorized by the law of the state". The enactment incorporates the law of the state, as found in the statutes and decisions of the highest state court. In *City of Marion* v. *Sneeden*,[47] the Supreme Court reiterated its opinion that the National Banking Act did not confer the power to pledge assets to secure any public deposits but those made by the Secretary of the Treasury and *specific* federal funds, and decided the controlling question whether Illinois had authorized its state banks to pledge assets to secure public deposits of its political subdivision. The Court found that neither by the common law, as found in the decisions of the highest court of Illinois, nor by statutes,[48] which were similar to New York laws on the subject, were state banks authorized to pledge assets to secure public moneys of a city It follows then, by virtue of the 1930 Enabling Act, that the national banks' pledge was *ultra vires.*

The cases involving national banks have definitely indicated a trend toward the restriction of the power of banks to the statutory grant.[49] Where the interest of the public, as expressed by statute, does not demand that public funds be secured, the interest of the general depositor will be supreme.[50] In this connection one must examine the decision in *Inland Waterways Corp.* v *Young*.[51] This case deals with the power of a national bank to pledge its assets to secure a deposit of federal moneys by corporations created and controlled by the government; and while it does not involve public funds of a state, it does evidence a change of the judicial approach in the determination of the powers of national banks. In line with pre-

---

[44] Capital Sav. and Loan Ass'n v. Olympia Nat. Bank, 80 F (2d) 561 (C. C. A. 9th, 1935).

[45] "Any association may upon the deposit with it of public money of a state or any political subdivision thereof, give security for the safe-keeping and prompt payment of the money so deposited, of the same kind as is authorized by the law of the state in which such association is located in the case of other banking institutions in the state." 46 STAT. 809, 12 U. S. C. A. § 90 (1930).

[46] Lewis v. Fidelity and Deposit Co., 292 U. S. 559, 564, 54 Sup. Ct. 848 (1934).

[47] 291 U. S. 262, 54 Sup. Ct. 421 (1933).

[48] CAHILL'S 1931 ILL. REV. STAT. c. 130, par. 29; CAHILL'S 1931 ILL. REV. STAT. c. 16a, par. 11.

[49] Texas and Pac. Ry. v. Pottorff, 291 U. S. 245, 54 Sup. Ct. 416 (1933), City of Marion v. Sneeden, 291 U. S. 262, 54 Sup. Ct. 421 (1933).

[50] *Ibid.*

[51] Inland Waterways Corp. v. Young, 309 U. S. 517, 60 Sup. Ct. 646 (1940), *rev'g*, Inland Waterways v. Hardee, 69 App. D. C. 280, 100 F (2d) 678 (1938).

vious decisions, *O'Connor* v *Rhodes,*[52] decided in 1935, held that a national bank could not pledge its assets to secure deposits by the United States Alien Property Custodian and deposits by the United States Shipping Board M. M. Fleet. In the *Inland Waterways* case it was said that the statutes commanding the Secretary of the Treasury to exact security for "public money" deposited by him in national banks is an exaction of duty from the secretary as to moneys subject to his control and is not a limitation upon the power of the bank to give security when it may be required by other government officers and agencies charged with custody of federal funds. Although the Supreme Court, speaking through Mr. Justice Frankfurter, claimed the basis of its decision to be the holdings in *Texas Ry.* v *Pottorff* and *City of Marion* v *Sneeden,* it said that the National Banking Act cannot be strictly construed but must be read, in conjunction with its history, as a manifestation of national practice and given scope consonant with the reason for its development. This was strongly condemned in the dissenting opinion [53] which maintained that the powers of a national bank were only those conferred by the language of the Act as held in the two cases mentioned above. The Court said. [54]

> What may be inimical to the private aspects of the national banking system, and therefore *ultra vires,* has no such relevance to the public aspect of national banks, and to the enforcement of the public interest by those charged with primary responsibility for its guardianship. * * * But when legality itself is in dispute—when Congress has spoken at best with ambiguous silence—a long continued practice pursued with the knowledge of the Comptroller of the Currency is more persuasive than considerations of abstract conflict between such a practice and purposes attributed to Congress.

This would indicate that what seems to be a radical departure from the trend of federal decisions, with respect to the power of national banks to pledge their assets, is merely a change in the method of determining what the public interest is. It is doubtful whether this case will affect the trend of state and federal court decisions relative to the pledge of assets to secure state public funds. The decision appears to be another manifestation of the "new Court's" attempt to remove the restraints imposed by the "old Court" upon the activities of the legislative and executive branches of the government.[55]

---

[52] 65 App. D. C. 21, 79 F (2d) 146 (1935), *aff'd,* 297 U. S. 383, 56 Sup. Ct. 517 (1936).

[53] *Per* Roberts, J., Holmes, C. J., and McReynolds, J., concurring. Reed and Murphy, JJ. took no part.

[54] 309 U. S. 517, 523, 60 Sup. Ct. 646 (1940).

[55] Wolfe, *The Supreme Court—Then and Now* (1941) 15 ST. JOHN'S L. REV. 188, 190.

The Ultra Vires Pledge

The *City of Yonkers* case, *supra,* which involved a New York national bank, posed an additional problem raised by the decisions in the New York courts. The court found that, whereas New York State banks have not the legal authority to pledge their assets to secure all deposits, the Court of Appeals recognizes a power to do so insofar as the exercise of such *ultra vires* power may create an estoppel not only against the corporation, but also against its general creditors.[56] In line with the general law of *ultra vires* contracts the Court has consistently held that before the bank may repossess its assets it must return what it has received in the transaction.[57] The United States Supreme Court and the courts of several states, on the other hand, hold that the bank is not estopped from recovering its pledged assets, it need return only the *pro rata* share to which a general depositor is entitled.[58] Although the federal courts also maintain that one is estopped from retaining benefits derived under an *ultra vires* contract,[59] they distinguish the type of contract under discussion and make an exception of it. The rationale is that such a contract is against public policy and void; the law will not permit to be done indirectly that which cannot be done directly; the doctrine of estoppel should not be permitted to circumvent the public policy of the nation.[60] In *Texas & Pacific Ry.* v *Pottorff*[61] it was contended that, although the bank's agreement should be held to be *ultra vires,* estoppel would prevent its saying so. The circuit court pointed out that the suit was not upon benefits received by the bank, but on the contract, in which case the corporation could not be bound upon an illegal contract. Such holding seems to dodge the issue and what was said above is more reliable.

Because of the different effects attributed to the *ultra vires* pledge in the New York and federal courts, it was argued in the *Yonkers* case that the bank had the power to pledge, since under the Enabling Act it might do what the state banks could do. This argument was rejected on the ground that a national bank could do only what the state bank was "authorized" to do. The fact that the state bank had the "power" to secure a deposit did not mean that its conduct was authorized by law. The plaintiff city also argued that, pursuant to the decision in *Erie Ry.* v *Tompkins,*[62] to the effect

---

[56] Yonkers v. Downey, 106 F (2d) 69 (C. C. A. 2d, 1939).

[57] Appleton v. Citizen's Central Nat. Bank, 190 N. Y. 417, 83 N. E. 470 (1908), see generally PRASHKER, CASES AND MATERIALS ON THE LAW OF PRIVATE CORPORATIONS (1937) c. VI.

[58] Marion v. Sneeden, 291 U. S. 262, 54 Sup. Ct. 421 (1933), Wood v. Imperial Irrigation Dist., 216 Cal. 748, 17 P (2d) 128 (1932), People v. Wiersema State Bank, 361 Ill. 75, 197 N. E. 537 (1935).

[59] See note 51, supra.

[60] Smith v. Baltimore and O. R. R., 56 F (2d) 799 (C. C. A. 3d, 1932).

[61] 63 (F (2d) 1 (C. C. A. 5th, 1933).

[62] 304 U. S. 64, 58 Sup. Ct. 817 (1938).

that there is no federal common law, the federal courts must apply the common law of New York. This was denied by the district court which said that the Enabling Act provided for the incorporation of state law only in the determination of the validity of the pledge. As to the effect of an *ultra vires* pledge, the regulation of the conduct of national banks is peculiarly in the power of the Federal Government; the matter being governed by federal statute, the decision in the *Erie* case has no effect.

Conclusion

The earlier cases on the subject which have held that a bank may hypothecate its assets to secure a deposit of public funds were so decided primarily because of a desire to protect the public. To do so the courts reasoned to their conclusion from the theory of a sovereign's priority in the payment of debts, from the fact that an accepted authority on the subject of banking had stated a deposit to be in legal effect a loan [63] and by citing as authority cases [64] which were decided on a dissimilar set of facts but which, by way of *dicta*, might substantiate the desired proposition. Such case is *Ward v Johnson*,[65] decided in 1880, which upheld the pledge because the transaction appears to have been a loan rather than a deposit. But the case has never been referred to in any Illinois court decision nor has there been any manifestation in an Illinois case of an exercise of such power on the part of a state bank.[66] In *People v Wiersema State Bank*,[67] decided in 1935, the Illinois Supreme Court held invalid a pledge of assets to secure the deposit of a political subdivision of the state because the state statutes did not authorize such a pledge. While the early cases upholding the pledging of bank assets are still relied upon the tendency of the later decisions, is to adopt the view that in the absence of statutory authority, the banks have no such power. As has been pointed out the practice is, quite prevalent with respect to public funds, but only because they are expressly provided for by the statutes of the several states. Examples of a change of attitude are the decisions of the courts of Arizona and Texas,[68] which formerly approved such pledge but no longer do so. Of supreme consideration is the interest of the public, not so much in the security of public moneys as in the welfare of the banks and in the protection of the equality of the rights of those deal-

---

[63] 1 MORSE, BANKS AND BANKING (6th ed. 1928) 665.

[64] Ward v. Johnson, 95 Ill. 215 (1880), Ahl v. Rhoads, 84 Pa. 319 (1877).

[65] 95 Ill. 215 (1880).

[66] See Marion v. Sneeden, 291 U. S. 262, 54 Sup. Ct. 421 (1933).

[67] 361 Ill. 75, 197 N. E. 537 (1935).

[68] Button v. Sanguinnetti, 40 Ariz. 329, 11 P (2d) 1085 (1932); Foster v. Longview, 11 S. W (2d) 217 (Tex. Civ. App. 1928), *rev'd*, 26 S. W (2d) 1059 (Tex. 1930), Austin v. Lamar County, 11 S. W. (2d) 553 (Tex. Civ. App. 1928), *rev'd*, 26 S. W (2d) 1062 (Tex. 1930).

ing with them.[69] The common design has been to insure, in case of disaster, uniformity in the treatment of depositors and a ratable distribution of the assets.[70]

BERNARD SCHIFF.

LIABILITY OF HOSPITALS FOR THE NEGLIGENCE OF THEIR EMPLOYEES

The cases on the subject of charitable hospital liability "present an almost hopelessly tangled mass of reason such as is not often encountered in the law.... The question is one which the courts have been fertile in drawing subtle distinctions, many of them irrelevant to the point for discussion, or, at least, leading to no principle by which the conclusions reached can be reconciled." [1] An abundance of opinion reveals a marked dissatisfaction with the status of the law today, and evidences a positive desire that hospital liability conform to the changing *mores* of the times. For the purposes of this article, the subject of liability will be approached from the various agencies purporting to claim exemptions from tort liability. A discussion of the damage liability of charitable, state and municipal hospitals will be had in order.

Charitable Hospitals

One of the earliest cases in this country deciding that a charitable hospital is exempt from tort liability to a patient is that of *McDonald* v. *Massachusetts General Hospital*.[2] In the formation of the immunity rule, this case has been frequently cited and approved.[3] In turn, the only authority relied upon in that case was a decision of an English court.[4] That this case was shortly overruled and the subsequent status of the American decisions impaired is evidenced by the statement of Kennedy, L.J., "With the American . . . cases . . . I do not think it necessary to deal. They are not in agreement; in one of them [citing the *McDonald* case] the judgment appears to have been influenced by an English decision of *Holliday* v. *St. Leonard, supra,* which has been overruled by the House of Lords in *Mersey Docks* v. *Gibbs*." [5]

---

[69] People v. Wiersema State Bank, 361 Ill. 75, 197 N. E. 537 (1935).
[70] *Ibid.*

[1] Zollman, *Damage Liability of Charitable Institutions* (1921) 19 MICH. L. REV. 395, 408.
[2] 120 Mass. 432 (1876).
[3] Tucker v. Mobile Infirmary Ass'n, 191 Ala. 572, 68 So. 4 (1915); L. R. A. (1915D).
[4] Holliday v. St. Leonard, 11 C. B. (N. S.) 192 (1861).