THE CURRENT ACCOUNT AND SET-OFFS BETWEEN AN INSOLVENT BANK AND ITS CUSTOMER

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The purchase and sale in the open market of government and corporate bonds, treasury notes, and the acceptances and notes of persons of established and widely known credit standing is an important part of the business of a commercial bank. But the greater number and volume of its transactions are the borrowing, the lending and the agreeing to lend money at short term. The majority of such transactions are with persons who deal regularly with the bank. The transactions with each customer are numerous. They take a great variety of forms. During a single day a bank may receive on account of a customer many distinct advances of money. Some of the advances are payments received from the obligors of bills, notes and checks left with the bank for collection; some are money received as the price of securities left with the bank for sale; some are received from other banks by means of cable and letter transfers; others are advances made by the customer himself. Each of these advances either creates an obligation or affects an already existing one. But what obligation is created or which existing obligations are affected is not always clear. In exchange for some of the advances the customer receives a time or demand certificate of deposit; for some, credit on his "savings account"; for some, bank notes; for another, a traveler's letter of credit. But in the case of others the bank makes no express promise. On the same day the bank may make equally numerous advances for the account of the same customer. Some are made against the customer's checks to third persons; some, under letters of credit; some, in pursuance of instructions to make cable transfers; some, for securities purchased for the customer; some, upon the presentation of the customer's notes and acceptances; and others are advances to the customer himself. Each of these advances either creates an obligation of the customer or extinguishes in whole or in part an existing obligation of the bank. But in

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instances in which there is no express bargain between bank and customer at the time of the advance—and this is usually the case—what obligations are created or extinguished is not clear.

There are other types of transactions between bank and customer which are perhaps more important than those which have been mentioned. None of them is an advance; they are agreements to make advances. One is the loan or discount for a customer of his or another’s note or bill. Another is the issuance of a letter of credit against the customer’s express promise to put the bank in funds or to reimburse it. These transactions differ from those which have been enumerated in that they result in placing an obligation upon both bank and customer. But such of them as are loans or discounts are like some of the advances enumerated in that the bargain is not expressed but must be implied in fact. Loans or discounts are, therefore, peculiar both in that the bargain must be implied in fact and in that the bargain is bilateral, obligating both bank and customer.¹

Thus, at any particular moment it would not be surprising to find a bank under a number of discrete obligations to the same customer and the customer likewise obligated to the bank by virtue of several distinct bargains. For example, the bank has issued to him its certificate of deposit, its cashier’s check, and its letter of credit; and the balance of mutual advances which were not accompanied by express promises is in favor of the customer. The customer is bound to reimburse the bank under a letter of credit agreement which he has signed; and he is the borrower in a loan or discount transaction.

In the situation existing at such a moment, in so far as the bargains were express agreements, the time of performance, amount and direction of the obligation resulting from each of them is fixed by reference to its terms. But in so far as the several transactions were not accompanied by express agreements the time of performance, amount and direction of the obligation are found in the bargain implied in fact from the regular course of business. In many situations it will appear that in all of the transactions between bank and customer the bargain must be implied in fact. These may, and in order to facilitate analysis

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"It appears, therefore, that by taking the credit instrument [note] to state the customer’s side of the bargain a sensible bargain cannot be constructed. Whether the implied-in-fact promise of the bank be assumed to be unlimited or limited in point of time, unconditional or conditional, the bargain and the legal consequences conforming to its terms would be absurd.

"It is necessary, therefore, to look for the customer’s promise outside the promissory note. Both sides of the bargain must be implied in fact." Id. at 393.
will, be separated into two groups: those which do not include loan or discount transactions, and those which do.

In situations of the first type, all the transactions, it will be observed, are either those in which the bank has made advances of money to the customer or those in which the customer has made advances of money to the bank. The transactions of a single customer will serve as an example. At the beginning of the month the books of the bank showed an excess of receipts over disbursements on each of the three ledger accounts which regularly serve to record the deposits and the payments against checks which are earmarked for one or another of them; the ledger which records transactions not so earmarked also showed an excess of receipts over disbursements. During the month the bank received the purchase price of securities left by the customer for sale; received payment of a note and mortgage left for collection; collected checks, notes and bills drawn upon or payable at other banks; received cable transfers; and received from time to time either from the customer, or from third persons for his account, coin and Federal Reserve notes. Some of these receipts were earmarked for particular ledger records and others were not. During the same period the bank made disbursements against checks, paid notes and acceptances of the customer, made cable transfers upon the customer's instructions and handed coin and bank notes to the customer upon his personal demands. All of the disbursements against checks and some but not all of the others were earmarked for one or another of the three ledger accounts.

Each of these receipts, whether or not earmarked for one or another of the three ledger accounts, was a loan by customer to bank and each disbursement, whether earmarked or not, a loan by bank to customer. Each advance, were it an isolated transaction, would result in an obligation on the part of the borrower to pay the lender an equivalent sum. But since each loan was one of a series of reciprocal advances of money made in the regular course of business between bank and customer the obligation imposed on bank or customer is not to pay a sum equivalent to the sum lent, but to pay the difference between the total of the amounts borrowed and the total of the amounts lent. Such a series of advances between bank and customer is called a current account. The balance of the current account, i.e., the difference between the sum of advances by bank and the sum of advances by customer, determines the direction and amount of the obligation to pay.² The obligation to pay is performed only by

² LANGDELL, A BRIEF SURVEY OF EQUITY JURISDICTION (2d ed. 1908) 114-116; Moore and Shamos, INTEREST ON THE BALANCES OF CHECKING ACCOUNTS (1927) 27 COL. L. REV. 633-634; Moore and Sussman, op. cit. supra note 1, at 386-389.
the payment of the adverse balance; the payment of a lesser sum is a loan. Although there is always an obligation on one or the other to pay the balance of the current account, the party so obligated may or may not be under an obligation to make loans. The obligation to lend, if it exists at all, depends, as in the case of the checking account, on an express or implied-in-fact bargain which is quite distinct from the implied-in-fact bargain controlling the obligation to pay the balance of the current account. It is the balance of all the advances on the current account, whether or not they are earmarked for particular ledger accounts, which determines the direction and amount of the obligation to pay. Usually the amount of the obligation to lend is also determined by the balance of the current account but sometimes the agreement stipulates some other measure. The obligation to lend is commonly but not always performed by honoring the checks of the customer for amounts less than or equal to the total amount of the obligation to lend. It will be observed that the obligation to lend differs from the obligation to pay the balance in respect of the damages recoverable for its breach and may differ in respect of amount. In the ordinary case in which the dealings between bank and customer continue or are expected to continue the obligation to pay the balance of the current account is rarely performed. Usually the bank has made an implied-in-fact promise to lend by honoring the customer's checks. The bank's obligation to honor checks is so necessary an adjunct of the business activities of the customer that he regularly makes loans to the bank though he has not agreed to do so. It is only by making such loans, earmarked or not, depending on the understanding with the bank, that he can require the bank to continue to honor checks. It appears, therefore, that in the first type of situation in which there is no express bargain the determination of the amount of the obligation of bank or customer to pay the balance and the direction in which it runs (whatever may be said of the obligation to lend) is simply a matter of computing the difference between the sums of the two series of advances.

In the second type of situation in which there is no express

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5 Bransby v. East London Bank, 14 L. T. (N. S.) 403 (1866).
bargain the transactions include loans and discounts as well as mutual advances. In a loan or discount the bank receives from its customer either his own note payable to the bank or a bill or note made by a third person and indorsed by the customer. Such transactions are commonly analogized to open market purchases and thought of as implied-in-fact bargains for the purchase and sale of the note, but it is clear that they are nothing of the sort. The implied-in-fact bargain pursuant to which the note is delivered to the bank is one in which the bank—not in exchange for a quid pro quo but in exchange for a promise—promises during a period of time to pay or to lend up to the amount of the note. This promise is for an amount over and above the sum which it is already obligated to pay or to lend by virtue of mutual advances. The customer, on the other hand, promises to pay, at the end of that period, the amount of the debit balance of the current account and pledges the note with the bank as collateral security for his obligation to pay that amount. If a time note is given the loan period expires at the maturity of the note; if a demand note, upon notice. "The bank promises and is obligated to lend the agreed amount until the expiration of the agreed period and the customer promises and is obligated to pay at the end of that period the amount by which the transfers of the bank exceed his transfers to it. The customer's promissory note plays the part of collateral security for the customer's obligation. This it can do, because, though it does not subject the customer to a duty to pay the bank, the bank acquires a privileged power to pledge or discount—repledge or rediscount—it for its own obligations. The note transaction is, therefore, in substance the familiar British device for extending bank credit for definite periods by means of a bargain between bank and customer obligating the bank to honor the customer's overdrafts up to a

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6 Moore and Sussman, op. cit. supra note 1, at 389–400.
stated amount during a stated period and obligating the customer
to pay the debit balance at the end of that period."

Although this type of situation has been distinguished because
it includes mutual promises, as a matter of course both bank and
customer continue to make advances during the agreed period
so that at its end the amount of the obligation to pay and its
direction are determined in the same way as in the situation in
which all the transactions are advances. But throughout the
agreed period both bank and customer are obligated.

The notion that the implied-in-fact bargain upon the loan or
discount of a note is not an agreement to lend expiring at the
end of the agreed period but a purchase is perhaps more insistent
if the instrument which the bank has discounted be the bill, note
or acceptance of a third person indorsed by the customer. Those
who entertain this notion make two points. The first is that if
the note is paid by the maker at maturity the amount of the
bank's obligation to the discounting customer remains the same
as before payment. Therefore it cannot be contended that the
obligation of the bank arising by virtue of the loan or discount
expired at maturity. But the conclusion that the amount of the
bank's obligation has not diminished need not be derived from
the proposition that the loan or discount imposed an obligation
on the bank as purchaser to pay the price. It may equally well,
and for the sake of logical simplicity should, be derived from the
proposition that the note was taken by the bank as security for
an obligation to pay the debit balance at the end of the agreed
period. If the bank is a pledgee, then, the payment of the note
by the third person was an advance to the bank for the account
of the customer which increased the balance of the current ac-
count by an amount equal to the amount by which the expiration
of the loan agreement diminished it. Their second point is that
if the note is not paid by the maker the customer is not obligated
to the bank by virtue of the loan or discount unless he has in-
dorsed and then only as indorser upon due presentment and
timely notice of dishonor. But this point cannot be sustained.
It is true no action may be maintained against the customer as
indorser unless he has indorsed and the necessary steps upon
dishonor have been taken. But he is obligated to pay the debit
balance of the current account at the expiration of the loan
period. And this obligation is wholly independent of his obliga-
tion as indorser. Indeed it is imposed upon him even in the cases
in which he has not indorsed or has indorsed "without re-

8a Moore and Sussman, op. cit. supra note 1, at 393.
9 See, for example, National Commercial Bank v. Miller & Co., 77 Ala.
168 (1884); Lyons v. Union Exchange Nat. Bank of New York, 150 App.
Perhaps the idea that the bank's failure to present and give notice to the customer discharges him is the result of confusing the situation with one in which there are indorsers obligated to the customer. In such a case it may be that failure to present and give notice to the prior indorsers, or any other conduct on the part of the bank which would impair the value of the collateral, would discharge *pro tonto* the customer's obligation to pay the debit balance.\(^{31}\)

Upon the sequestration of the assets of an insolvent commercial bank the receiver, who is charged with their liquidation and distribution, will find that they fall into two groups. The first includes the assets which will be liquidated by sale; the second, those which will be liquidated by collection. In the first, in addition to money in the till, land, buildings and tangible chattels owned by the bank, are government and corporate bonds and acceptances and notes of persons of established and widely known credit standing bought in the open market. The second includes obligations of customers acquired in transactions with them and obligations of persons, sometimes but usually not customers, also acquired for the most part in transactions with customers. Similarly the liabilities of the insolvent estate will appear to fall into two classes: those to customers and those to others arising out of transactions with customers; and liabilities to others arising out of transactions with persons who are not customers. The liquidation by sale on the open market of assets of the first group and the liquidation by collection of obligations of third persons which were not acquired from customers do not present difficult legal questions. Neither does the determination of the amounts of the liabilities to third persons which do not arise out of transactions with customers.

But in the case of obligations and of liabilities arising out of transactions with customers the determination of the amount which the receiver may collect or the amount which the customer may prove sometimes presents difficulties and sometimes does


\(^{31}\) See, for example, *Aebi v. Bank of Evansville*, 124 Wis. 73 (1905); *Taft v. Quinsigamond Nat. Bank*, 172 Mass. 363, 52 N. E. 387 (1899). If there are no prior indorsers but the debtor is the drawer of a check given to the creditor for the debt, the creditor's failure to present does not discharge the debtor beyond the amount of the ensuing loss occasioned by the want of presentment. *Farmers' Oil & Gas Co. v. Betts*, 50 S. D. 78, 208 N. W. 402 (1926); *Grange v. Reigh*, 93 Wis. 552, 67 N. W. 1130 (1896). See also *McCrary v. Carrington*, 35 Ala. 698 (1860); *Kephart v. Butcher*, 17 Iowa 240 (1864).
not. If the obligation or liability arose from a single transaction which included the express promise of customer or of bank the determination is easy since the express promise is controlling. Again if the obligation or liability is for the credit or debit balance of the current account and the only transactions have been advances no serious problems are presented. But if there are cross obligations arising from a loan or discount or cross obligations resulting from several distinct transactions then the determination in these situations of the amount which the receiver may collect or the amount for which the customer may prove does require the careful distinction of one type of situation from another, minute analyses of each and precise discrimination in the choice and application of legal rules. It is with these situations that this article is concerned.

Receiver and Customer Who Is Maker of Matured Note

Among the most often recurring situations is the one in which the receiver finds among the assets a matured note or a demand note received by way of loan or discount from a customer between whom and the bank there has also been a series of mutual advances of money made in the regular course of business. Neither in the loan or discount nor in the case of any of the advances was there an express agreement defining the obligation of the parties though there may in connection with some of the advances have been an implied-in-fact bargain to honor checks. The transactions were recorded in the single individual ledger account in which all the transactions were recorded, or in one of the several accounts if more than one set of individual records were kept for the customer. A credit entry for the amount of the note was made, and perhaps on or after the day of maturity a debit entry. At least one of the accounts shows a book or apparent “credit balance” but in fact the balance of the current account may be either in credit, in debit, or in balance.

In respect of such a situation it will be recalled, first, that the series of mutual advances of money constituted a current account which by itself and quite independent of the loan or discount imposed upon the bank the obligation to pay the credit balance and upon the customer the obligation to pay the debit balance; secondly, that the loan and discount is not a transaction upon the current account notwithstanding its deceptive entry on the individual ledger card as a credit along with the advances of money received from the bank; thirdly, that the obligations arising from the loan or discount depend upon the implied-in-fact bargain made at the time of the loan. The obligation imposed on the bank is to lend the amount of the note (less the discount) plus the credit balance or minus the debit balance of the current
account during the period ending with the maturity of the note if a time note, or if it be a demand note, during a period terminating upon notice. The obligation imposed on the customer is to pay the debit balance of the current account at the expiration of the agreed period and the note is security for that obligation. Coincidentally with the maturity of the note, or the notice, the obligation of the bank to lend the agreed amount expires by its terms; the obligation of the customer to pay becomes due if there is a debit balance of the current account, or is performed if there is a credit balance.

The sequestration of the assets upon the insolvency of the bank (whatever its effect may have been upon the obligation to lend) has done no more than convert the bank’s obligation to pay the credit balance, if any, into a claim in favor of the customer for a distributive share of the assets. The customer continues as before to be obligated to pay the debit balance. The same rules which determined the direction and amount of the obligation of bank or customer before the sequestration of assets control the direction of the obligation or liability and measure its amount. As before the sequestration, the face of the note does not measure the obligation.

Thus, if the advances by customer exceeded the advances by bank, i.e., if there were a credit balance of the current account, the receiver, even in an action at law on the note, may not recover against the customer but the customer has a provable claim against the insolvent estate for the credit balance. If the current account is in balance then neither has the receiver a right nor the customer a claim. The note, which was held as security for a debit balance which did not and under the circumstances will not come into existence, must be returned to the customer. These conclusions follow whether all of the advances were recorded in a single ledger account, or whether some were

22 Hammons v. Grant, 26 Ariz. 344, 225 Pac. 485 (1924); Steelman v. Atchley, 98 Ark. 294, 135 S. W. 902 (1911); People v. California Safe Deposit & Trust Co., 168 Cal. 241, 141 Pac. 1181 (1914); First Nat. Bank of Rocky Ford v. Lewis, 57 Colo. 124, 139 Pac. 1102 (1914) (seemle); Lippitt v. Thomas Loan & Trust Co., 88 Conn. 185, 90 Atl. 369 (1914); State v. Brobston, 94 Ga. 95, 21 S. E. 146 (1894); Meyer v. Hiatt, 40 Ga. App. 583, 150 S. E. 567 (1929); Miles v. Bossert, 173 N. E. 656 (Ind. App. 1930); Bodley v. Bowman, 293 Pac. 740 (Kan. 1930) (seemle); Beatty v. Scudday, 10 La. Ann. 404 (1855); Bernstein v. Coburn, 49 Neb. 734, 68 N. W. 1021 (1896); In the Matter of Van Allen, 37 Barb. 225 (N. Y. 1861); Coburn v. Carstarphen, supra note 4; Bank of Woodward v. Robertson, 111 Olds. 58, 228 Pac. 844 (1925); Upham v. Bramwell, 105 Ore. 597, 209 Pac. 100 (1922). Contra: Armstrong v. Helm, 13 Ky. Law 460 (1891).


24 Steelman v. Atchley, supra note 12.
recorded in one and some in others of several ledger accounts. They also follow if advances, which by virtue of express bargains do not affect the balance of the current account, were entered in one or another of the ledger accounts recording advances which do not affect that balance.

If, on the other hand, the advances by bank exceeded the advances by customer, i.e., if there were a debit balance of the current account, the receiver has a cause of action against the customer for the debit balance whether it be more or less than the note, and may retain the note until the debit balance is paid. Moreover, if the receiver hold more than one of the customer's notes he may retain all of them notwithstanding the customer's demand though the face amount of any one exceed the debit balance. The customer, however, may redeem the note or notes by paying the debit balance.

To be contrasted with the rules prescribing the legal consequences of the loan or discount are the rules as to set-off of independent causes of action which are derived from the decisions and statutes regulating the administration of insolvent estates and from the ordinary statutes as to set-offs and counterclaims. The former define the legal relations of lending bank and borrowing customer who have not made an express bargain at the time of loan or discount. At the maturity of the loan agreement either bank or customer, but not both, are obligated to pay. The latter presuppose two distinct bargains, one obligating bank to customer and the other customer to bank. They provide when one of the obligations may not, when it may, and when it must be set off against the other. Between receiver and customer the doctrine of set-off is applicable, for example, when all the ad-

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15 Bailey v. Finch, supra note 4; Advance Exchange Bank v. Baldwin, supra note 4; Coburn v. Carstarphen, supra note 4; and see supra note 4.
vances were made pursuant to express bargains to repay the advance and none, therefore, affected the balance of a current account; or when bank and customer have severally purchased from third persons in the open market the obligations of the other. The customer holds the insolvent bank's certificate of deposit, its bank note, its acceptance, its letter of credit, a claim for a time deposit in the form of a "savings account" or any other obligation of the bank resulting from an express bargain to pay a fixed sum. The receiver holds the customer's note and mortgage upon which the bank had made an advance by way of loan which by express agreement is not to affect the balance of a current account; the customer's matured obligation to reimburse for advances under a letter of credit; the note, acceptance or warrant of the customer bought in the open market; or any other obligation of the customer resulting from an express bargain to pay a fixed sum. May or must the matured obligation of one be set off against the matured obligation of the other? Had the two creditors not been in the relation of bank and customer it would be clear enough that in an insolvent administration under most circumstances the matured claims of one would be set off against those of the other. That they were bank and customer does not make the claims less available as set-offs.

Generally their availability is determined by statutes and decisions which have no peculiar application to insolvent banks. Obviously among the instances in which between receiver and customer independent causes of action are set off should be included the common case in which the bank or customer is obligated to pay the balance of the current account and the other is obligated by virtue of an express bargain to pay a fixed sum.

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21 Set-off of debit balance and cause of action in favor of customer: Adams v. Spokane Drug Co., supra note 17 (draft in favor of customer, drawn by insolvent bank and dishonored by drawee); Green v. McCord, 204 Ala. 364, 85 So. 752 (1920) (claim for indemnity for payment made by customer as surety for insolvent bank); Taylor v. Cox, supra note 19 ("savings deposit"); Lippitt v. Thames Loan & Trust Co., supra note 12 ("savings deposit"); Robinson v. Aird, supra note 17 (claim for payment made by customer for account of bank); Williams v. Johnson, supra note 17 ("savings deposit"); Miller v. Receiver of Franklin Bank, supra note 17 (bank notes); Seymour v. Dunham, 24 Hun 93 (N. Y. 1881) (certificate of deposit); Fisher v. Davis, 278 Pa. 129, 122 Atl. 224 (1923) (non-fiduciary special deposit); Bank of Pennsylvania v. Spangler, 32 Pa. 474 (1859) (bank notes); Jones v. Piening, 85 Wis. 264, 55 N. W. 413 (1893) (special deposits, fiduciary and non-fiduciary); Johnston v. Humphrey, 91 Wis. 76, 64 N. W. 317 (1895).

The obligation to pay the balance of the current account arises from an implied-in-fact bargain which is quite distinct from the obligation resulting from the express bargain, but the case is as clear a one for set-off as were the other instances.

To the statement that the receiver or customer may set off obligations arising from independent obligations there are two conspicuous exceptions. Both have been formulated to effectuate the policy underlying statutes regulating banking. In some states, state banks which receive time deposits in the form of "savings accounts" are required to invest and keep invested the money so received in securities earmarked for the savings department and segregated from the other assets of the bank. In those jurisdictions, if out of the segregated funds the bank has made a loan and the customer expressly bargained to repay it, giving his note and mortgage, against his liability on the note the customer may not set off his claim for the credit balance of his current account or his claim for a time deposit in the form of a "savings account," or his claim upon any other obligation of the insolvent bank. To permit the set-off would lessen by the amount of the claim set off, the value of the assets which, pursuant to the statute, have been segregated for the "savings" depositors. It should be observed, however, that this policy does not preclude the set-off of the customer's claim for a time deposit in the form of a "savings account" against his obligation to pay the debit balance of the current account, or against any other of his obligations to the receiver. The other exception results from statutes imposing double liability upon stockholders. This liability is created for the benefit of creditors who are entitled to the distribution of its full value equally among them. Hence the conclusion that the customer who is also a stockholder and therefore obligated to pay upon his stock may not, against this liability, set off a claim against the estate.

396 (Kan. 1930) in which the receiver sought to recover assets preferentially transferred to customer.


23 Taylor v. Cox, supra note 19; Lippitt v. Thames Loan & Trust Co., supra note 12; Williams v. Johnson, supra note 17.

A second situation in which both bank and customer are obligated as a result of a loan or discount of the customer's own note is precisely like the first except that the note has not matured before the sequestration.

It will be recalled that the loan or discount was not a transaction in which the bank received a *quid pro quo* but was a bargain, executory on both sides, in which the bank promised to lend upon demand an agreed sum during an agreed period and the customer promised to pay the debit balance at the end of that period, giving his note as security therefor. It will also be recalled that the content of the customer's obligation after the sequestration is the same as the content of his obligation before the sequestration. Thus when the agreed loan period does expire, but not before, the customer is obligated to pay the receiver the amount of the debit balance, if there be any. It might be thought that the amount of the customer's claim against the estate should be measured by the amount of the bank's obligation to him, that is, the sum of the amount of the credit balance of the current account and of the amount which at the time of sequestration had not been advanced by the bank under its executory promise in the loan and discount transaction. But the amount of the customer's claim is instead measured by the credit balance of the current account alone. The obligation of the bank to lend beyond this sum was extinguished upon the sequestration of the bank's assets. It is true that before the sequestration the customer was, after actual demand, entitled to specific performance of the bank's promise though that promise was given in exchange for an unperformed promise and not for a *quid pro quo* which has been received. It must be admitted that an argument, founded upon the absence of a demand, against including in the amount of the customer's claim against the estate the amount not yet lent under the executory bargain does not ring true in the ears of either layman or lawyer. The real ground for not permitting the customer's claim to include the full amount of the bank's executory promise to lend is that it would be futile, in a proceeding for the winding up of a business by liquidating the assets and distributing the proceeds among creditors, to allow a proof of claim for an amount which the customer as a borrower would be obligated to repay to the receiver. The sequestration is in effect an injunction against the performance of the bank's executory promise which both disallows specific performance and also precludes the recovery of damages for its breach after the sequestration. The amount of the customer's claim is, therefore, measured by that part of the bank's obligation to him which arose
by virtue of transactions in which the bank had actually received a *quid pro quo*.

Thus, if the advances by customer exceeded the advances by bank so that the balance of the current account was in credit, the receiver cannot recover from the customer either before or at the end of the agreed loan period. The customer, however, has a provable claim for the credit balance and may also compel the return of the note which is being held as security for a non-existent debit balance. But if, on the other hand, the balance of the current account is in debit, the receiver may, at the expiration of the agreed loan period upon the maturity of the note, recover the debit balance from the customer. Meanwhile until the debit balance is paid the receiver may retain the note or notes as security even though the amount of any one exceed the debit balance. The customer, however, may redeem the note or notes upon payment of the debit balance.

In addition to the problem of determining the direction and amount of the obligation resulting from the loan or discount, the receiver will be faced with the question whether in the process of liquidation unmatured debts of bank or customer may or must be set off against matured debts of the other. For answer he must look to the decisions and statutes regulating set-off of independent debts in the administration of insolvent estates. If the obligation of the insolvent is matured and the obligation of the creditor unmatured, one is set off against the other and the amount which the receiver may recover or the amount which the

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29 *Supra* note 18.

creditor may prove is the difference. For example, if the bank holds an unmatured note of a customer which it bought in the open market and the customer holds a matured certificate of deposit then the one is set off against the other. But if the obligation of the insolvent is unmatured and the obligation of the creditor matured the statutes and decisions differ as to whether or not the amount which the receiver may recover or the creditor prove is the difference between the two claims. In some jurisdictions it is held that if the obligation of the insolvent is unmatured each party recovers the full amount of his obligation undiminished by the amount of the other. Thus, if the customer's obligation to reimburse the bank for advances made under a letter of credit is due and the customer holds the bank's unmatured certificate of deposit, whether one of them has a claim for the difference between the two obligations or whether the receiver may recover on the letter of credit agreement and the customer prove for the amount of the certificate of deposit depends upon the jurisdiction in which the question is raised.

Receiver and Accommodating Party Who Has Signed the Note for the Customer's Accommodation

In either of the two situations in which the receiver finds among the sequestered assets the note of a customer which has been discounted for him it may appear that the note bears the signature of an accommodating party. If so, the receiver may choose to proceed against the surety. It will be recalled that the customer's obligation as a party to the note was acquired by the bank as collateral security for the customer's obligation to pay the debit balance of the current account at the end of the agreed loan period. For the same reason the obligation of the accommo-

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31 McCagg v. Woodman, 28 Ill. 84 (1862) (credit balance and note bought in open market); Partch v. Boyle, 197 Iowa 1314, 197 N. W. 33 (1924) (credit balance and rent); Mercer v. Dyer, 15 Mont. 317, 39 Pac. 314 (1895) (credit balance and county warrants); Kilby v. First National Bank, 32 Misc. 370, 66 N. Y. Supp. 579 (1900) (claim for indemnity for payment made by customer as surety for insolvent bank and debit balance); Mandel v. Koerner, 149 N. Y. Supp. 455 (Mun. Ct. 1914) (credit balance and rent); Comfort v. Patterson, 70 Tenn. 679 (1879) (certificate of deposit and note); Johnson v. City of Aberdeen, 147 Wash. 452, 266 Pac. 707 (1928) (credit balance and city warrants); Maryland Casualty Co. v. Grays Harbor Co., 293 Pac. 441 (Wash. 1930) (credit balance and county warrants); Jones v. Pleining, supra note 17 (special deposits, fiduciary and non-fiduciary, and debit balance); Clark, Set-Off in Cases of Immature Claims in Insolvency and Receivership (1920) 34 Harv. L. Rev. 178; (1932) 80 U. of Pa. L. Rev. 420, 421.

32 Taylor v. Weir, 63 Ill. App. 82 (1895); Andrews v. North English Savings Bank of North English, 231 N. W. 293 (Iowa 1930) (unmatured certificates of deposit and debit balance); In the Matter of Van Allen, supra note 12; Clark, supra note 31; (1932) 80 U. of Pa. L. Rev. 420, 422-426.
dating party is collateral security for the customer's obligation to pay the debit balance. The bank, upon the maturity of the note, might have recovered against the accommodating party no more than the amount of the customer's debit balance. Ordinarily a pledgee may recover the amount on the face of a negotiable instrument though the instrument be pledged to secure a lesser sum. However, if recovery of the full amount will result in circuity of action the recovery is limited to the amount of the debt for which the instrument is pledged. If the bank were permitted to recover the full amount of the note from the accommodating party it would hold the amount by which the recovery exceeded the debit balance for the customer who in turn would be under a duty to reimburse the accommodating party for the full amount paid by him to the bank. It will also be recalled that upon the sequestration of the assets the customer, whether his note had or had not then matured, is at maturity obligated to pay the debit balance of the current account.

Thus, if the balance of the customer's current account were in debit the receiver can recover from the surety on the note no more than the amount of the debit balance and the surety upon payment of this sum can compel the receiver to surrender the note. And if the note has not matured prior to the sequestration the receiver may not recover until the expiration of the loan period. But if the balance of the current account were in credit the receiver can recover nothing, and the surety may require the receiver to cancel his signature.

The limitation of the receiver's recovery against the accommodating party to the amount of the debit balance of the current account is not an application of rules derived from the cases deciding when a surety may rely upon set-offs and counterclaims which would be available to the principal debtor if the creditor were proceeding against the principal. If it were, doubtless there would be found the same diversity of decision between receiver and accommodating party which characterizes that group of cases. By these decisions if the principal is solvent and there is no special statutory provision the surety sometimes is, but usu-

34 Wilbur v. Mortgage Loan Co., supra note 33.


36 Supra notes 19 and 30.
ally is not, permitted to plead his principal’s set-offs. If the principal is insolvent, the insolvency may make a difference and result in permission to the surety to avail himself of the principal’s set-offs. If the assets of the insolvent principal debtor have been sequestered the intervention of the rights of creditors of the principal may make a difference. These are the decisions which would be controlling if, in an action in which the receiver sought to recover no more than the debit balance, the accommodating party sought to plead by way of set-off or counterclaim the customer’s cause of action on, for example, a certificate of deposit.

There remains the distinct question whether in a situation in which the accommodating party himself has a claim against the insolvent estate, the receiver may recover the full amount of the customer’s debit balance and the surety prove for the full amount of his claim or whether the amount which the receiver may recover or the customer prove is merely the difference between the amounts of their claims. This question is obviously a matter of setting off independent causes of action and its solution depends upon the decisions and statutes regulating the administration of insolvent estates. It will be observed that the question is the same as that presented by the situation in which the customer who is obligated for the amount of his debit balance has an independent cause of action against the insolvent estate. But the two situations are unlike in that the solvency of the customer which was regarded as immaterial in the situation in which the parties were bank and customer is a factor of paramount importance in determining whether or not the claims of receiver and accommodating party may be set off. Thus, if the customer is solvent the receiver may recover the full amount of the customer’s debit balance and the accommodating party must prove for the full amount of his claim. But if the customer is insol-

37 Niblack v. Feldman, 204 Ill. App. 443 (1917); Armstrong v. Warner, supra note 33.
38 Fidelity & Deposit Co. v. Duke, 293 Fed. 661 (1923); Armstrong v. Warner, supra note 33.
vent the claims of receiver and accommodating party may, under certain circumstances, be set off. If the accommodating party holds a claim which was due at the time of sequestration, as, for example, a matured certificate of deposit, then, whether or not his obligation to pay the customer's debit balance was then due, the two causes of action are set off. But if the claim of the accommodating party was not due at the time of sequestration then the situation is doubtless similar to that in which the customer held an unmatured claim against the insolvent bank and doubtless the same difference of opinion should be expected.

**Receiver, Customer and Third Person Whose Bill or Note Was Discounted for the Customer**

A third situation in which both bank and customer are obligated as a result of a loan or discount is precisely like the first two except that the receiver instead of holding the note of the customer holds a matured or unmatured note indorsed by him. The instrument was made or drawn by a third person and delivered to the customer for value received from him in the course of a business transaction.

It will be recalled that, as in the other loan or discount situations, the bank, by virtue of the implied-in-fact bargain between the parties, became obligated to lend an agreed sum during an agreed period and the customer became unconditionally obligated to pay the debit balance at the end of that period. The instrument, whether the customer indorsed it, indorsed it "without recourse," or did not indorse it at all, was collateral security for the customer's obligation to pay the debit balance. Unlike the other loan and discount situations, the customer's obligation on the instrument, if he has indorsed it, is conditional upon presentment and notice of dishonor. But want of presentment and notice, whatever its effect upon the obligation of the customer as indorser may be, does not extinguish his unconditional obligation to pay the debit balance. Nor, on the other hand, does the making of presentment and the giving of notice increase the amount of the customer's obligation to pay the debit balance for which the note is collateral. As in the other loan and discount situations, upon the sequestration of the assets, the customer...
either continues to be obligated to pay the debit balance of the current account or has a provable claim for the credit balance.

Thus, if the current account is in credit the receiver has no cause of action against the customer but the latter may prove for the credit balance and compel the receiver to surrender the note. But if there is a debit balance, the receiver can recover its amount from the customer who by paying may redeem the note. Until the debit balance is paid the receiver may retain as collateral security the note upon which the maker is obligated.

Once the amount of the customer's obligation to the receiver or the customer's claim against the estate has been determined, then, the problems of set-off must be faced. These problems and their solution are no different in the situation under discussion than they were in the one in which the receiver held the customer's own note.

The proposition that in the case of the discount of a third person's note, the obligation of the maker is collateral security for the customer's obligation to pay the debit balance of the current account is not at all inconsistent with the conclusion that the receiver may recover the full amount of the note from the maker even if the existence of a credit balance discloses that the customer-principal debtor is not obligated. In any event the bank is a holder of the note to which there is no defense. If the maker has no defense against the payee, his indorsee, whether agent, donee, or whatever, may recover the full amount of the note. It is true the receiver would, under the circumstances supposed, hold the amount received for the customer, just as would any pledgee who has realized upon the collateral more than is necessary to satisfy the principal debt.

The conclusion that the receiver may recover from the maker the face amount of the note, whatever the balance of the current

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43 Williams v. Coleman, supra note 42.

44 Balbach v. Frelinghausen; O'Connor v. Brandt; Williams v. Coleman, all supra note 42.


46 People v. Canal Street Bank, supra note 45. But the customer may not redeem by offering to set-off a "savings deposit." Bryant v. Williams, 16 F. (2d) 159 (1926).

47 Bryant v. Williams, supra note 46.

48 Cosmopolitan Trust Co. v. Lyons, 244 Mass. 115, 138 N. E. 325 (1923).
account, is perfectly consistent with the proposition that the receiver can recover against an accommodating party upon a note made by the customer no more than the amount of the debit balance. That proposition is derived from the rule against circuity of action. The receiver who recovered the face amount of the note from the accommodating party would be accountable to the customer for the surplus over the debit balance, and the customer would in turn be obligated to reimburse the accommodating party. But if, as in the case under discussion, the customer acquired the note from the maker for value in a business transaction, the customer is not obligated to reimburse the maker. On the contrary the maker was obligated on the note to the customer.

If the situation under discussion be changed by supposing that by reason of fraud and deceit the maker of the note has a defense against the customer, then the receiver may recover from the maker no more than the debit balance. This result is not in


Of course, if the debit balance of the current account is equal to or greater than the amount of the instrument, the bank may recover its face. Sherrill v. Merchant's & Mechanic's Trust & Savings Bank, 195 Ala. 176, 70 So. 723 (1916); Pasadena National Bank v. Shorten, 96 Cal. App. 461, 274 Pac. 558 (1929); First National Bank of Fresno v. Corcoran, 105 Cal. App. 116, 286 Pac. 1105 (1930); Anglo California Trust Co. v. French American Bank, 291 Pac. 621 (Cal. App. 1930); City Deposit Bank v. Green, 130 Iowa 384, 106 N. W. 942 (1906); Smouse v. Waterloo Savings
conflict with the proposition that the receiver may recover the face amount from a maker who has no defense even if there be a credit balance, but is explained, as is the restriction of the amount of recovery against an accommodating party on a note of a customer, by the rule against circuity of action.

It may be that the maker, from whom the receiver may recover the full amount of the note acquired by the insolvent bank from the payee-customer (or the debit balance if there is a defense to the note), is also a customer and has an independent claim against the insolvent estate, for example, for the credit balance of his own current account or on a certificate of deposit. Whether the maker must prove for the full amount of his claim or whether the amount which he may recover is the difference between the amounts of their claims are questions the solution of which depends upon the statutes and decisions regulating the administration of insolvent estates.50

In the situation under discussion the instrument which the bank received from its customer was the note of a third person. Had the instrument been the bill or acceptance of a third person, the results would be the same. It is perhaps less obvious that the legal relations between bank and customer would be the same were the check of a third person taken, not for collection, but under an implied-in-fact bargain to make advances to the customer up to its amount. That the check is payable on demand, is a token calling for the immediate payment of money, and is promptly liquidated, obscures the fact that the transaction was in fact a loan, that is to say, a "loan or discount." The customer


In a few jurisdictions the bank may recover the amount on the face of the instrument on the ground that the bank's promise to extend credit is of itself value. Ex parte Richdale, L. R. 19 Ch. Div. 409 (1881); Royal Bank of Scotland v. Tottenham, 2 Q. B. 715 (1894); Bank of British North America v. Warren Co., 19 Ont. L. Rep. 257 (1909); Blacker v. Nat. Bank of Baltimore, 151 Md. 514, 135 Atl. 383 (1926).


becomes obligated to pay the debit balance at the end of the loan period, that is, upon notice, and the check plays the part of collateral security for the debit balance.\textsuperscript{51}

**Receiver, Customer, Accommodating Party, and Third Person if the Bill or Note After Its Discount Has Been Earmarked for the Savings Department**

The separate investment of funds derived from time deposits in the form of “savings accounts” is, in some states, required of state banks. And the investment of funds of the savings department in instruments previously discounted in the course of the bank’s commercial business is not uncommon. In the discussion of the situations in which both bank and customer become obligated by virtue of a loan or discount it has been assumed that the note or other instrument which was taken as collateral had not thereafter been earmarked and placed among the segregated assets of the savings department. If the note had prior to the sequestration been segregated in some manner satisfying the statute requiring the segregation of the assets of the savings department,\textsuperscript{52} nevertheless the legal relations of bank, customer, accommodating party and third person, with two exceptions derived from the statutes are the same as if the note had not been earmarked. Both exceptions are devised to enable the receiver to realize for the “savings” depositors the face amount, i.e., the apparent value of the notes and other securities which in pursuance of the statute have been set aside for their protection. The first of them is that the receiver may recover the full amount of the note whatever the balance of the current account between the customer and bank may be.\textsuperscript{53} The second is that against his obligation on the note neither customer nor third person may set off any claim he may have against the insolvent bank.\textsuperscript{54}

\textsuperscript{51} Supra p. 1114.

\textsuperscript{52} Bassett v. The City Bank and Trust Co. (Conn. Sup. Ct., April 29, 1932).


"The theory of the interveners is that the assets required to be segregated do not include notes of depositors at their full face, but at their face less deposits of the makers and indorsers.

"For example, a bank has a note for $5,000 given by A., who has a deposit of $2,000. The bank segregates the note as security for savings deposits."
Doubtless to the extent that the receiver recovers more than he would have recovered from the customer were the action for the debit balance the customer, by way of reimbursement is given a claim against the insolvent estate.\(^{55}\)

**Rediscounting Bank, Receiver, Customer, Accommodating Party and Third Person if the Bill or Note Has Been Rediscounted**

Prior to the sequestration the insolvent bank may have exercised its privileged power to borrow by way of loan or discount at its bank upon the notes or other items which it obtained in the course of loan or discount transactions with its own customers. The transactions in the course of which the insolvent bank rediscounted these items are similar to those loan and discount transactions in which the insolvent bank obtained from its customers the notes, bills and checks of third persons; and the legal relations between insolvent bank and rediscounting bank resulting therefrom are like those between bank and customer in the situation referred to. Thus the insolvent bank came under an obligation to pay the rediscounting bank the amount of its debit balance and the various items were collateral security. Obviously such transactions also result in legal relations between the rediscounting bank and the persons obligated on the items rediscounted. Examination of these legal relations becomes of real importance upon the insolvency of the borrowing bank and the sequestration of its assets.

At the outset it should be observed that unless there has been a misappropriation by the insolvent bank which gives rise to a defense in favor of the parties obligated upon the rediscounted items\(^{56}\)—and certainly the rediscount alone is not a misappropriation—the rediscounting bank may recover the full amount of the item against any party who was obligated to pay the full amount to the customer. As to the customer himself, or a person who signed for his accommodation, or one who had a defense against the customer, whether or not and how much the rediscounting bank may recover depends upon two factors. They are the state of the current account between the two banks and the state of the current account between the insolvent bank and the

\[^{54}\text{Dole v. Chattabriga, supra note 53.}\]

\[^{55}\text{Cosmopolitan Trust Co. v. Suffolk Knitting Mills, supra note 53.}\]

\[^{56}\text{Puget Sound State Bank v. Washington Paving Co., 94 Wash. 504, 162 Pac. 870 (1917).}\]
customer from whom it acquired the rediscounted item. If the debit balance of the current account between the insolvent bank and the rediscounting bank is equal to or greater than the amount of the items rediscounted then the rediscounting bank may recover the full amount of the note from the person obligated upon it. But if there is no debit balance in the current account between the two banks or if the rediscounting bank has already recovered on some items the amount of the debit balance, then the rediscounting bank cannot recover more than the receiver could recover from the person on the rediscounted item. In other words, if the rediscounting bank has no beneficial interest as pledgee, the recovery against a person on the rediscounted item depends upon the existence of a debit balance in the current account of the customer from whom the insolvent bank acquired the item. This result is derived from the rule against circuity of action. If there was no debit balance between the two banks or if the rediscounting bank has already realized a sufficient amount to reimburse itself, any amount which it would recover would be held for the receiver.

It will be observed that if there is a debit balance in the current account between the two banks so that the rediscounting bank may recover the full amount of the rediscounted item from a person obligated thereon, such person may be obligated to pay an amount which he would not have had to pay or a greater amount than he would have had to pay if the item had not been rediscounted. This result would follow if the balance of the current account between customer and insolvent bank were not in debit or if the debit balance were less than the amount of the


Obviously a cause of action against the insolvent bank may not be set off against the rediscounting bank, Munger v. Albany City National Bank, 85 N. Y. 580 (1881).

note. In such a situation the person who is thus subjected to a liability secures, by way of reimbursement, a claim for an equal amount against the assets of the insolvent bank.\(^6\)

It may be that the person obligated upon the rediscounted item is a customer of the rediscounting bank and has an independent cause of action against it. Whether or not the amount of the claim may be set off against the claim of the rediscounting bank on the rediscounted item is a question the solution of which depends upon the decisions and statutes regulating the administration of insolvent estates.

What the legal relations between rediscounting and insolvent bank are has already been suggested. Except for the fact that as between the two banks it is the customer-bank (the borrowing bank) and not the banker-bank (the rediscounting bank) whose assets have been sequestered the legal relations would be substantially the same as in the situation in which the customer had given the bank an instrument of a third person. The rediscounting transaction, in addition to creating legal relations between the borrowing and the rediscounting bank and between the rediscounting bank and the parties to the rediscounted items, also affected the legal relations between the insolvent bank or its receiver and the persons on the items. If subsequent to the sequestration the receiver redeems the item, the legal relations between receiver and any person on the note is exactly the same as if the item had always remained in the bank's portfolio.\(^6\) What those relations are has already been described. But if the rediscounted item has not been redeemed then any person who is required to pay the rediscounting bank an amount which he would not have to pay the receiver or which exceeds the amount which he would have to pay the receiver is entitled to a claim for an equal amount against the assets of the insolvent estate.\(^6\)

Of course the possibility should not be overlooked that prior to the sequestration the insolvent bank may have sold in the open market notes, acceptances or other items received from its customers by way of loan or discount. But this possibility is seldom actualized. Realization on such items is almost always by way of loan or discount at the bank's bank. Doubtless were there such a sale it would not be a breach of duty on the part of the bank;\(^6\) and the receipt of the price would be an advance upon the current account between the bank and the customer from whom the item was received.

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\(^6\) Hall v. Burrell, 22 Colo. App. 278, 124 Pac. 751 (1912); Leach v. City-Commercial Savings Bank, \textit{supra} note 58; In re Bank of Minnesota, 71 Minn. 394, 73 N. W. 1096 (1898); Merchants Ice & Fuel Co. v. Holland Banking Co., 8 S. W. (2d) 1030 (Mo. App. 1928).


\(^6\) \textit{Supra} note 60.