C O P Y

X-7004

October 26, 1931.

Mr. M. G. Wallace, Counsel,
Federal Reserve Bank,
Richmond, Virginia.

My dear Mr. Wallace:

Please accept my sincere apologies for not acknowledging more promptly your kind letter of July 9, 1931, transmitting for my information a copy of an opinion that you had given to Governor Seay with reference to the effect of the decision of the Circuit Court of Appeals in the case of Gamble v. Wimberly, 44 Fed. (2nd) 329, on the rights of Federal reserve banks against receivers of insolvent national banks. I have been literally overwhelmed with work and this is the first opportunity I have had to read your letter and the enclosures with care.

I agree with your conclusion that the decision of the Circuit Court of Appeals is wrong, because it is in conflict with the decisions of the Supreme Court of the United States, and it will be advisable for one of the Federal reserve banks located in another circuit to attempt to take a test case on this question to the Supreme Court of the United States when a favorable opportunity presents itself. I am therefore transmitting a copy of your letter and the enclosures thereto and a copy of this letter to Counsel for all Federal reserve banks for their information.

If any steps have been taken to obtain a review of the decision of the Circuit Court of Appeals by the Supreme Court of the United States, or if there have been any further developments with respect to the practical application of this decision in the administration of the affairs of the insolvent national banks by the Comptroller of the Currency, I should appreciate it if you would kindly advise me.

With kindest personal regards and best wishes, I am,

Cordially yours,

Walter Wyatt,
General Counsel.

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FEDERAL RESERVE BANK

OF RICHMOND

July 9, 1931

Federal Reserve Board,
Washington, D. C.

Attention: Mr. Walter Wyatt, General Counsel.

My dear Mr. Wyatt:

I am enclosing you herewith a copy of an opinion that I have given to Mr. Seay, the Governor of this bank, upon the subject of the decision of the Circuit Court of Appeals in this circuit in the case of Gamble v. Wimberly.

If the reasoning of the court in this case is carried to its logical conclusion it will probably involve considerable changes in the working arrangements which were agreed upon by Counsel for all Federal reserve banks and representatives of the Comptroller of the Currency at the joint conference held July 13th, 1925. You will see from my opinion that I am inclined to consider that the reasoning of this case is contrary to the previous decisions of the Supreme Court, and I attach to my opinion a memorandum of the previous federal decisions which were cited and relied upon by the court in rendering the opinion in the case under discussion.

I do not know just how far the office of the Comptroller will be disposed to extend the rule laid down in this case; but in certain correspondence which I have had with receivers it seems that the Comptroller may be disposed to consider that this case necessitates a material alteration in the principles upon which his office has previously acted.

You will notice that the case holds only that dividends cease when collections upon collateral and previous dividends equal to the amount of the proven claim without interest. There has been no decision that the lien upon collateral ceases before interest has been paid, and the case of Murrill v. National Bank of Jacksonville and other cases appear to be authority for the rule that collateral secures interest as much as principal. Upon the other hand, if the right to receive dividends ceases as soon as the principal is paid but the collateral then on hand may still be held for the interest, the decision results in making a distinction where there is no difference, for it means that collateral liquidated before a dividend tends to reduce the amount of dividends paid to the creditor, but if the creditor does not liquidate his collateral until after the dividends he may get the full dividends and then collect accrued interest out of the collateral.

In a proposed settlement which was submitted to me by a receiver

Mr. Walter Wyatt,
Federal Reserve Board,
Washington, D. C.

July 9, 1931

I notice that the receiver had apparently assumed that all collateral and all payments received from makers of rediscounted notes should be added together and when the Federal reserve bank had received from any source a sum equal to its original claim without interest this right to dividends ceases. Payments made by makers are, of course, not made from assets of the insolvent bank's estate and the ordinary rule is well established that a payment by a maker of a note is first applicable to a reduction of accrued interest and afterwards to the reduction of the principal. I can see no reason why the fact that the endorser of a note becomes insolvent should alter the rule as to application of payments by the maker and I can see nothing in the decision of the Circuit Court of Appeals which shows that the court would of necessity adopt such a conclusion, although I admit that a line of reasoning similar to that which the court adopted with respect to the application of the proceeds of collateral might well lead to the adoption of a similar rule reversing the usual rule concerning the application of payments made by parties to the obligation.

The proposed settlement to which I alluded also appeared to have been prepared upon the theory that the proceeds of stock held by the insolvent bank in a Federal reserve bank would of necessity be applied just as money realized from collateral. We, of course, have heretofore been so handling the surrender value of the stock because it was a convenient way of keeping the account and did not affect the ultimate rights of the parties. It does not appear to me that it necessarily follows that the surrender value of the stock is for all purposes analogous to collateral pledged, because the acts seem to contemplate that the surrender value of the stock shall not be applied except in the final closing of the account, which would of necessity mean the payment of interest upon any past due obligation.

It has also been the practice of the Comptroller's Office in closing the books of a failed bank before paying a final dividend to distribute the collections made upon collateral pro rata to each rediscount. This, of course, was immaterial as long as collections made upon collateral did not affect our right to dividends until each note was paid in full, but if the distribution of the proceeds of collateral is to affect the rights of dividends on a particular note, it is obvious that in some instances it will be much more advantageous to the Federal reserve banks to apply the proceeds of collateral to some note upon which the makers have made no payments and upon which the balance due upon principal exceeds any dividend which will be paid rather than to distribute collateral upon certain notes upon which large part payments have been made by makers, so that the payments from the makers plus the distribution of collateral will exceed the principal amount due on the note. It seems to me that the holder of the collateral is clearly entitled to apply it upon any obligation selected by him and cannot be compelled to prorate it among all obligations.

There may be other questions which will arise, and the above

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Mr. Walter Wyatt,
Federal Reserve Board,
Washington, D. C. -3- July 9, 1931

propositions represent only my tentative opinion. I have not as yet made a full study of any of the questions other than the single one considered in the case of Gamble v. Wimberly. It occurred to me, however, that your office and perhaps Counsel for the other Federal reserve banks might be interested in the probable effect of this decision and I therefore send you a copy of my opinion of July 1st and the memorandum of cases.

With kindest regards, I am,

Very truly yours,

(S)

M. G. Wallace,
Counsel.

MGW R

C O P Y

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FEDERAL RESERVE BANK OF RICHMOND

July 1, 1931

Mr. George J. Seay, Governor.

M. G. Wallace, Counsel.

Decision of the Case of Gamble v. Wimberly Relating to the Computation of Interest on Claims Against Insolvent Banks.

My dear Mr. Seay:

I wish to call your attention to an opinion in the case entitled Gamble v. Wimberly, decided by the Circuit Court of Appeals for the Fourth Circuit October 21, 1930, and reported in 44 Federal Reporter (2nd) 329, which may necessitate some change in the computation of interest in our settlements with failed banks upon claims for which we hold security.

As you know, there are two distinct rules adopted in different jurisdictions concerning the basis upon which dividends should be paid to creditors of an insolvent who hold security for their debts. One rule is generally called the English chancery rule and under it a creditor proves a claim for the amount of his debt as it existed at the time of bankruptcy or insolvency, making due allowance for interest accruing prior to insolvency or for rebate of interest on claims not due. The creditor then receives dividends on his claim until the amount of dividends and the amount realized from collateral equal to the amount of the claim.

The second rule is commonly referred to as the bankruptcy rule and under it a creditor is obliged to liquidate his collateral and credit the amount realized from it before proving a claim, or else to appraise his collateral and credit its estimated value. The creditor then receives dividends only upon the net amount due after due allowance is made for the value of the collateral.

There are certain minor variations in the application of these rules so that it is often said that there are four distinct rules, but I mention them as two because the two distinct rules present the only points of difference with which we are concerned at this time.

Some years ago at a conference between representatives of the Comptroller of the Currency and representatives of Federal reserve banks it was generally agreed that the English chancery rule was the proper rule to apply in claims against insolvent national banks. This conclusion seemed to be in accordance with several decisions of the Supreme Court of the United States. You will readily observe that in the application of this rule at any time after insolvency a statement of the amount due on the preferred claim will always involve two distinct amounts. For the purpose of determining the amount of dividends payable the fixed sum due as of the date of insolvency is always the unchanging basis. To determine the entire amount due the creditor interest must be accrued on the claim to the date at which a settlement is contemplated. The Supreme Court held that as

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long as the claim remained unpaid the creditor was entitled to dividends on the original amount of the claim irrespective of collections on collateral until the claim was paid.

We and representatives of the Comptroller of the Currency have until now both assumed that the claim was not paid until the entire amount due the creditor had been received by him; that is to say, that the creditor was entitled to treat dividends merely as part payments and to credit them along with receipts from collateral until receipts from both sources applied as part payment equalled to the amount of the claim and accrued interest.

In the decision to which I allude the Circuit Court of Appeals has held that this is not true, but that when the creditor has received from dividends and from the principal or corpus of his collateral an amount equal to the proven claim the right to receive dividends ceases, or, putting the matter in a slightly different way, the court has held that receipts from the corpus of collateral cannot be applied to accrued interest on the debt.

The case to which I refer arose as follows: The Commercial National Bank of Wilmington failed, owing to the First National Bank of Rocky Mount a note of $25,000.00 secured by certain customers' notes of the Commercial National Bank of Wilmington. The First National Bank of Rocky Mount had on deposit in the Wilmington bank the sum of $3,402.90. After the failure the First National Bank of Rocky Mount consolidated with another bank and the claim against the Commercial National Bank of Wilmington was transferred to a liquidating trustee. The trustee proved a claim upon the note and the deposit balance mentioned above and collected in the process of time from the collateral in his hands the sum of $23,331.30. Dividends were paid to the trustee aggregating $4,260.44. The trustee applied the proceeds from collateral first to extinguish accrued interest on the note, for which it was pledged, and the balance to reduce the principal on the note and applied the dividends to reduce the principal. The accrued interest amounted to $2,372.89. When the time for a final dividend came the trustee contended that there was due to him the sum of $3,184.05, which the final dividend would have been sufficient to pay in full. The Receiver of the Wilmington bank contended that the amount due was only $311.16; that is to say, that so far as the payment of dividends was concerned the claim was discharged when the payments received equalled to the dividend basis and that accrued interest could not be taken into consideration. The District Court sustained the contention of the trustee and the case was taken to the Circuit Court of Appeals. Judge Coleman in the opinion cited above reversed the District Court, stating the question as follows:

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"Summarized, the question presented for our decision is whether a creditor of an insolvent national bank may be permitted to apply collections from collateral security which he holds to the liquidation of interest accruing upon his claim subsequent to the bank's insolvency, before applying such collections to the reduction of the principal of his claim."

After reviewing nearly all of the previous decisions of the federal courts upon the subject the opinion states the conclusion of the court as follows:

"Summarizing our conclusions, we find that whereas the judgment of the lower court was correct in so far as it required the receiver to pay dividends ratably to the trustee based upon the latter's original claim, it was nevertheless, in error in permitting the trustee to apply collections from collateral to the liquidation of interest, as the trustee did and thereby increase the amount still unpaid, of his original claim by the amount of interest so liquidated. Although not required to do so, the trustee having in fact sold the collateral, the total of all dividends paid and anticipated being much less than the full amount of his claim, he should apply in further liquidation thereof, not merely the balance of the proceeds realized from the collateral (as he has voluntarily done), but the total amount of such proceeds less only any interest and dividends that may have accrued upon the collateral itself since the date of the Wilmington bank's insolvency."

The opinion contains certain expressions from which it might be argued that the court intended to hold that when the creditor had collected an amount equal to the proven claim the entire claim of the creditor was discharged and he would not only receive no further dividends, but would be compelled to surrender his collateral. These expressions appear to arise chiefly from the fact that the Circuit Court of Appeals refers to decisions of the Supreme Court of the United States, saying that the creditor is entitled to receive dividends until such dividends and the proceeds of the collateral equal to the claim. I, myself, am inclined to think that the Supreme Court of the United States intended to say that the creditor could receive dividends and hold the proceeds of collateral until the entire debt was discharged, and the Circuit Court of Appeals has in reality restricted the effect of previous decisions of the Supreme Court. Therefore,

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M. G. Wallace, Counsel.

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in my own opinion the decision of the Circuit Court of Appeals is probaby unsound, but since the jurisdiction of the Circuit Court of Appeals of the Fourth Circuit includes all of the states of the Fifth Federal Reserve District, its decision must be accepted as law as far as we are concerned until the question is otherwise decided by the Supreme Court of the United States, and, as I say, the precise question has never been considered by the Supreme Court of the United States.

If this decision means that our lien upon our collateral ceases when we have received an amount equal to the claim as it existed at the date of insolvency, the decision would be a most important one; but, as I say, while the reasoning of the court appears to point to such a conclusion, the court has not taken its reasoning to that extent, and I think that in a subsequent case the court would be fully as likely to modify or limit its previous decision as it would to carry the reasoning of that opinion further.

I discussed this case informally with representatives of the Comptroller. They then informed me that they did not intend to take the position that our lien upon our collateral ceased before we had received payment of accrued interest, but merely that no dividends would be paid to us after we had received an amount equal to the dividend basis and that thereafter we would be left to our collateral to secure our accrued and accruing interest. This conclusion is illogical because it amounts in effect to saying that the proceeds of collateral may be applied to accrued interest if the proceeds are received after the estate is closed but may not be so applied if received before the estate is closed; but, as I stated above, this seeming inconsistency is apparently inherent in the distinction which the court made.

While the statements of the representatives of the Comptroller would not bind them in any way, as they were made in a merely informal discussion of the case and at a time when neither they nor I had had an opportunity to study it carefully, I am inclined to think that they intend to adopt the policy outlined above, at least until some further judicial decision is made.

It is, of course, not necessary to say that this opinion effects all Federal reserve banks, as well as this bank, and if, indeed, there is any thought of challenging the soundness of the opinion, it will be better for

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Mr. George J. Seay, Governor.

M. G. Wallace, Counsel.

Decision of the Case of Gamble v. Wimberly Relating to the Computation of Interest on Claims Against Insolvent Banks.

the question to be raised by some other Federal reserve bank as it would naturally be easier to secure an opinion from the Circuit Court of Appeals of some other circuit different from the opinion of the Circuit Court of Appeals of this circuit than it would be to induce the Circuit Court of Appeals of this circuit to reverse itself.

Accepting the opinion as the law for the time being, there are two points under it which we should consider: First, while the court holds that the proceeds from the corpus of collateral may not be applied to interest accruing after insolvency, it holds that interest on collateral may be so applied. We should therefore keep any interest received on collateral separate from the corpus or payments on principal or collateral and in a settlement with the receiver show only collections on principal or the corpus of collateral.

Second, in the case above quoted there was only one claim and consequently no doubt as to the application of collateral. In most cases in which we are concerned there are many claims and the collateral is held for all of the claims without distinction as to the particular claim. In some correspondence that I have had with one receiver he is inclined to the view that we are obliged to prorate collateral equally among all claims. I am inclined to think that we could apply collateral to any claim or claims which we preferred, as we do reserve balances, and so apply it upon notes which no payments had been made by the makers, and upon which, therefore, the balance due would exceed the dividends to be paid and the collateral to be applied.

It is probable that the rule as adopted by the Circuit Court of Appeals will not make any great difference in our settlements as far as the amounts received are concerned as it can operate only in those few cases in which a dividend would be sufficient with the application of collateral to pay the amount for which we had proved a claim but not sufficient to pay the claim and accrued interest.

Very truly yours,

M. G. Wallace,
Counsel.

MGW R

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MEMORANDUM UPON THE DECISION OF THE CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT OCTOBER 21, 1930, DELIVERED IN 44 FEDERAL REPORTER (2nd) 329.

The court in the case cited holds in substance that a secured creditor of a national bank may prove a claim for the present value of his debt determined at the time of insolvency and receive dividends on the amount so proven until the amount of dividends and the amount realized from the corpus of collateral held equal to the proven claim, at which time the right to receive further dividends ceases. The opinion does not decide whether or not the lien upon the collateral simultaneously ceases, but it is expressly stated that interest accruing upon securities held as collateral is applicable in partial payment of interest accruing upon the secured debt. In the course of its opinion the court cites and relies upon the following previous decisions of federal courts:

Story v. Livingston,
U. S. Sup. Ct. 1839, 13 Peters 359, 10 L. Ed. 200.

This was a bill filed for an accounting under Louisiana law against a defendant who seems to have been regarded as in a position analogous to that of a mortgageein possession, and the opinion delivered by Justice Wayne holds, among other things, that rents on the mortgaged property are applicable to reduce as part payments upon interest accruing on the mortgage debt during suit. It appeared, however, that the rents were more than sufficient to discharge the accrued interest and a portion of the rents were therefore applicable to the reduction of the principal.

National Bank of the Commonwealth v. Mechanics National Bank,
U. S. Sup. Ct. 1876, 94 U.S. 437, 24 L. Ed. 176.

This case holds that depositors in national banks are entitled to interest from the date of suspension on claims proven. It seems, however, that the assets were sufficient to pay all claims in full. The opinion, however, quotes with approval Lord Mansfield in Robinson v. Bland, 2 Burr. 1087, as follows:

> "The interest is an accessory to the principal, and the plaintiff cannot bring a new action for any interest grown due between the commencement of his action and the judgment in it. I don't know of any court in any country (and I have looked into the matter) which don't carry interest down to the last act by which the sum is liquidated."

Cook County National Bank v. United States,
U. S. Sup. Ct. 1882, 107 U. S. 445, 2 Sup. Ct. 561, 27 L. Ed. 534.

This case involved the right of a national bank to apply a surplus

from the sale of bonds to the payment of Government deposits. It was held that the United States was not a preferred creditor and the court does not appear to have considered with any particular care any question involving interest.

White v. Knox,
U. S. Sup. Ct. 1884, 111 U. S. 784, 28 L. Ed. 603.

This case holds that interest accruing after suspension cannot be added to a claim against an insolvent national bank for the purpose of determining the amount upon which dividends are payable.

Armstrong v. American Exchange Bank,
U. S. Sup. Ct. , 133 U. S. 433, 10 Sup. Ct. 450.

The primary question in this case was as to the validity of a draft issued in an unlawful transaction, but the court held that dividends which should have been paid to claimant but were withheld during the litigation should bear interest from the date that such dividends were paid to other creditors as this was necessary to place the creditor whose dividends had not been paid upon equality with other creditors.

Richmond & I. Construction Co. v. Richmond N. I. & B. Railway Co., Circuit Court of Appeals for Sixth Circuit, 68 Fed. 105, 34 L.R.A. 625.

This case was decided by Judges Taft. Lurton and Severens, and held that interest on a lien claim is payable to the claimant before anything is payable to general creditors or upon subsequent liens.

Murrill v. National Bank of Jacksonville,
U. S. Sup. Ct. Feb. 20, 1899, 173 U. S. 131, 19 Sup. Ct. 390, 43 L. Ed. 640.

The First National Bank of Paluka, Fla., was indebted to National Bank of Jacksonville in the sum of $6,010.47 on sundry drafts and in the sum of $10,093.34 upon a note for $10,000.00 and interest (probably to date of suspension). This note was secured by customers' notes of the Paluka bank aggregating $10,896.22. The First National Bank of Paluka was closed and a receiver appointed and the Jacksonville bank offered to prove a claim for the above amounts. The Comptroller of the Currency ruled that the amount collected on collateral must be credited before dividends were computed. The court says in an opinion by Chief Justice Fuller (173 U. S. 135) that there are four rules for computing dividends to creditors of insolvent estates:

"Rule 1. The creditor desiring to participate in the fund is required first to exhaust his security and credit the proceeds on his claim, or to credit its value upon his claim and prove for the balance; it being optional with him to surrender his security and prove for his full claim.

"Rule 2. The creditor can prove for the full amount, but shall receive dividends only on the amount due him at the time of distribution of the fund, that is he is required to credit on his claim, as proved, all sums received from his security, and may receive dividends only on the balance due him.

"Rule 3. The creditor shall be allowed to prove for and receive dividends upon, the amount due him at the time of proving or sending in his claim to the official liquidator, being required to credit as payments all sums received from his security prior thereto.

"Rule 4. The creditor can prove for and receive dividends upon, the full amount of his claim, regardless of any sums received from his collateral after the transfer of the assets from the debtor in insolvency, provided he shall not receive more than the full amount due him."

The court adopts the fourth rule, saying: (173 U.S. 141):

"We think the collateral is security for the whole debt and every part of it, and is to any balance that remains after payment from other sources as to the original amount due".

Justices White, Harlan and McKenna dissented, in an elaborate opinion by Justice White advocating the adoption of the first rule. Justice Gray filed a separate opinion sustaining the dissent but advancing somewhat different grounds.

Aldrich v. Chemical National Bank, U. S. Sup. Ct. March 5, 1900. 176 U. S. 618, 20 Sup. Ct. 498, 44 L. Ed. 611.

The Chemical National Bank discounted a certificate of deposit issued by Fidelity National Bank secured by certain notes. The chief question was with respect to the validity of the certificate, which was fraudulently issued by a Vice-President of the Fidelity National Bank for his own personal purposes.

The court held the certificate enforceable. A claim was also made that the certificate should be credited with the sum of $25,000.00 because the Chemical National Bank had released the endorser of a note for that amount held as collateral by failing to give notice of dishonor. In an opinion by Mr. Justice Harlan the court quotes with approval the opinion of the Circuit Court of Appeals for the Sixth Circuit decided by Judges Brown, Taft and Lurton, the opinion being written by Judge Taft (59 Fed. 372), as follows:

"Our conclusion upon this main question in the case makes it unnecessary for us to consider the other questions discussed by counsel, which were material only in view of the position taken by the court below on the issue just considered. If the Chemical Bank should receive from dividends and collections payment of debt principal and interest now

owing to it by the Fidelity Bank the question would arise whether it could not properly be charged with the note for $25,000.00, which, through negligence, it failed to collect. It is quite clear, however, that dividends declared and to be declared, together with all collections from collaterals including such as the note just referred to will fall short of paying the $300,000.00 and interest due the Chemical Bank on the original debt. The question suggested, therefore, does not arise on the facts of the case."

The opinion of the Circuit Court of Appeals also affirms the rule as to interest upon dividends which are not promptly paid.

Sexton v. Dreyfus,
U. S. Sup. Ct. Jan. 23, 1911, 219 U. S. 339, 31 Sup. Ct. 256, 55 L. Ed. 244.

Secured creditors sold collateral sometime after bankruptcy and offered to prove claims after applying the proceeds of collateral to accrued interest and then to principal. It was held that the proceeds of collateral must be applied to reduce the principal as the amount of the debt provable was determined at the time of bankruptcy, except the interest received on collateral after bankruptcy might be applied to reduce interest on principal. In the opinion by Justice Holmes it is said that the delay in selling the collateral benefitted the secured creditors. There is no discussion as to the effect of a fluctuation in the value of the collateral; that is to say, no discussion as to whether an enhancement in the value of the collateral after bankruptcy would be treated as income from collateral or merely as a part of the value of the corpus. This case arose from bankruptcy proceeding and applies the bankruptcy rule, although the court states that its conclusions find some support in the decisions applicable to the liquidation of national banks.

American Iron and Steel Mfg. Co. v. Seaboard Air Line Ry.,
U. S. Sup. Ct. April 6, 1914, 233 U. S. 263, 34 Sup. Ct. 502, 58 L. Ed. 949.

Dividends on a claim bearing interest should be paid on the amount of the debt with interest to the date on which the receiver was appointed, but interest is payable to all creditors if the estate is sufficient. The claim under consideration was a claim for supplies and therefore by statute a preferred claim, but the estate was returned to the defendant railway company and apparently all creditors were paid in full.

Washington - Alaska Bank v. Dexter Horton National Bank,
263 Fed. 304, C.C.A. 9th Feb. 24, 1920,

Dexter Horton National Bank preferred a claim against the Washington-Alaska Bank in insolvency proceedings. The last mentioned bank had been organized under the laws of Nevada, but was authorized to engage in business and had engaged in business in Alaska. The claim was for $129,465.62, for which the Dexter Horton Bank held as security certain gold mining stock.

Dividends amounting to 50% were paid to other creditors but none to the Dexter Horton National Bank. Then the receiver and the Dexter Horton National Bank made an agreement stipulating that $25,000.00 was to be paid to the Dexter Horton National Bank on account of dividends and the Dexter Horton National Bank agreed not to sell the collateral before December 1, 1912, and not before June 1, 1913, if the balance due it as dividends were paid. No further dividends were paid and the Dexter Horton National Bank in a foreclosure suit in a state court sold the collateral for $100,000.00, and after crediting this amount and the $25,000.00 received on account of dividends and adding interest (apparently on the whole claim), presented a claim for $27,248.76 and filed a suit in the federal court asking that the receiver be required to pay it in full. The lower court directed the receiver to pay the amount in full. On appeal this was sustained in a decision by Judges Gilbert, Ross and Hunt. The opinion deals chiefly with the applicability of a statute in Nevada, under the laws of which state the insolvent bank was organized. This statute was held inapplicable as the insolvent bank was authorized to do business and was doing business in Alaska, but Judge Ross dissented on this point. The opinion rests in some measure on the contract, but delivering the opinion of the court Judge Gilbert says:

> "A pledge which secures an interest-bearing debt secures the interest as much as the principal of the debt."

This case would apparently be directly in conflict with the case under consideration if it were not for the stipulation made between the receiver and the secured creditor before the collateral was sold, but the court does not apparently consider that the stipulation did more than acknowledge rights existing under the federal rules when the stipulation was made.

Ohio Savings Bank and Trust Co. v. Willys Corporation,
C.C.A. 2nd June 8, 1928, 8 Fed. (2nd) 463, 44 A.L.R. 1162.

This case holds that if an insolvent estate is able to pay all claims in full, including interest, dividends are to be credited as part payments on the claim, first applied to interest due when the dividends are paid and then to the reduction of principal. In other words, dividends are credited merely as part payments by a solvent person would be credited.

CONCLUSION

The difficulty of the question involved in the case under consideration appears to lie in the fact that under the so-called English chancery rule referred to in Murrill v. National Bank of Jacksonville as Rule 4, there are always two distinct aspects to a secured creditor's claim: one a provable amount determined as of the date of insolvency, the other the amount due with interest which would be payable in the absence of insolvency.

The secured creditor has also two distinct sources of payment, dividends reckoned always on the basis of the provable claim and the proceeds

of collateral which it seems under the decisions of the Supreme Court cited above are applicable either to principal or interest. The question involved is whether or not the claim of the secured creditor is discharged when he has received from his two sources a sum equal to the proven claim without the addition of interest or whether his claim is not discharged until he has received from the two sources a sum equivalent to his debt with interest, applying dividends and collections on collateral as part payments upon this debt.

There are three possible views:

1. The secured creditor is entitled to apply dividends and the proceeds of collateral merely as part payments and to receive dividends until his entire debt is discharged.

2. That he is entitled to receive dividends and the proceeds of collateral until the amount of the provable debt is paid, at which time his rights to dividends cease but he continues to have a lien upon collateral until the original debt and interest is paid.

3. That he can only receive dividends and apply the proceeds of collateral until an amount equal to the proven claim is paid, at which time his claim is discharged and dividends cease and the collateral must likewise be surrendered.

The first view appears to me to be in accord with the previous decisions of the Supreme Court, as in all of those decisions it is stated that the creditor has the right to receive dividends until his debt is paid and it is also stated that interest is an integral part of the debt. In no case does the Supreme Court suggest that the right to receive dividends and the lien upon the collateral do not end simultaneously.

The Circuit Court of Appeals has adopted the second view. I have found no decision that appears to have discussed the exact distinction made by the Circuit Court of Appeals as to the time at which dividends cease. There are expressions in the opinion of the Circuit Court of Appeals which tend to indicate that it would follow its conclusions to the point of adopting the third view, for there is no indication in the opinion of the court that, although the secured creditor would receive no further dividends, he still has a lien on the collateral. To carry this line of reasoning, however, to its logical conclusion would be in effect to deny the previous statements of the Supreme Court, saying that collateral is pledged for the entire debt and is not released until every part of the debt is paid, and in effect to declare that a creditor holding a debt amply secured by collateral lost his right to charge interest if the debtor became insolvent.

On the other hand, to adhere to the second and intermediate view is to reach the somewhat startling conclusion that the creditor who sells his collateral before his dividend is paid cannot hold the proceeds for interest accruing up to the time of sales but if he first receives dividends,

and after the insolvent estate is closed he may apply the proceeds of collateral to the payment of interest on the whole claim.

While it appears to me that to follow the reasoning of the Circuit Court of Appeals to its logical conclusion would result in the adoption of the third view it also appears to me that to carry its reasoning to this logical conclusion would render self-evident the fact that the reasoning of the Circuit Court of Appeals is divergent from the reasoning of the Supreme Court in the cases cited. It therefore appears to me that the decision of the Circuit Court of Appeals is unsound.

For practical purposes the rule announced in this case will not seriously affect Federal reserve banks, as it will operate only in cases in which dividends and collateral would be claims in full, but collateral and dividends up to the time at which payment of an amount equal to the proven claim and subsequent collections on collateral would not pay claims in full.

The decision, however, introduces several accounting questions: First, in that it will require a separate account for sums realized by collecting interest on collateral and sums realized by a sale or collection of the corpus of the collateral itself; and also opens the question that when collateral is pledged for many claims the creditor may allocate it to any claim which he sees fit or must prorate it equally upon all claims. The first view seems proper under the rule of bankruptcy which permits a creditor holding security for a non-provable debt and a provable debt to apply all the security upon the non-provable debt if he so desires.

The statement of the court that interest from collateral may be applied to interest on the claim is another evidence of the inconsistency of the court's reasoning since of necessity it would create a distinction between the type of collateral from which income is received by visible and readily computable payments of interest and the type of collateral in which income is received, if at all, by enhancement of the corpus.