2866.

BANK—RIGHT TO SET OFF VILLAGE FUNDS—USE OF CLASSES OF FUNDS BY VILLAGE—TRANSFER OF VILLAGE FUNDS—DEPOSITORY CONTRACT.

SYLLABUS:

1. *Although a depository bank has the right to set-off a debt which it owes, arising by virtue of a lawful deposit of village funds derived from taxation, without regard to the source of the funds on deposit, or the statutory limitations upon their expenditure, against a debt due from the village to the bank, it does not follow from a court decision recognizing such right that a village can use any and all of its funds legally on deposit for any and all public purposes, without regard to the statutory restrictions upon the use of different classes of funds. State ex rel Village of Warrensville Heights vs. Fulton,* 128 *O. S.,* 192, *discussed.*

2. *Under section* 5625-13, *General Code, moneys may be transferred from the general fund of a subdivision to the sinking fund or bond retirement fund to meet a deficiency in either of the latter funds. Opinions of the Attorney General,* 1933, *Vol.* 1, *p.* 648, *approved and followed.*

3. *A depository contract, made in accordance with sections* 4295 *and* 4296, *General Code, necessarily creates the relationship of debtor and creditor, there being no authority for drawing such contract so as to create a trust or bailment relationship in order to defeat or limit the bank's right of set-off.*

4. *Moneys in the sinking fund of a village, deposited by the sinking fund trustees under sections* 4514 *and* 4516, *General Code, may not be set off by the bank against a debt due it from the village.*

5. *Sinking fund moneys in the custody of the village treasurer, under section* 4516-1, *General Code, as part of the general balance of the subdivision, and deposited by him in the municipal depository by virtue of sections* 4295 *and* 4296, *General Code, are subject to the bank's right of set-off against a debt due it from the village.*

6. *If funds, constituting part of the general village balance, are deposited in a bank in any manner other than that prescribed by sections* 4295 *and* 4296, *General Code, and if the bank, at the time such funds are received, has knowledge of their public character, a special deposit is created, which the bank may not set off against a debt due from the village to the bank.*

7. *A judgment creditor of a village can not resort to a bank credit of the village, which represents the deposit of funds collected for the payment of bonds or notes issued by the village, in order to satisfy his judgment.*

COLUMBUS, OHIO, June 28, 1934.

Bureau of Inspection and Supervision of Public Offices, Columbus, Ohio.

GENTLEMEN:—You have requested my opinion on certain questions that have arisen by virtue of the recent decision of the Supreme Court in the case of *State ex rel Village of Warrensville Heights* vs. *Fulton,* 128 O. S., 192 (Ohio Bar, May 21, 1934). Your specific inquiries are stated in a letter from the solicitor for several villages in Cuyahoga County, as follows:

> "We have received inquiries from different villages which we represent as to whether or not this decision means that the statutory restrictions imposed upon the use of different classes of funds are abrogated when such funds are deposited in bank and the relation of debtor and creditor created; that is, can the villages now use gas tax moneys,

e. g., in the payment of general village obligations, and is the same true as to the proceeds of special assessments.

We are also receiving inquiries from other bondholders concerning their rights with respect to the particular special assessments pledged for the payment of their bonds, which special assessments heretofore collected and deposited in the bank, have now been applied upon the note held by the bank. What are we to say to these bondholders?

Furthermore, in view of the decision of the court, how can we protect the character of the different funds so as to preserve the limitations imposed by statute, which limitations the court has now set aside, at least to some extent. Must we carry each fund in a separate bank account and have an express agreement with the bank that it shall not be subject to offset, or what are we to do?

A still further possibility of prejudice to the funds on deposit is the matter of judgments obtained against the village by way of damages or otherwise. Will the judgment creditors have the right to attach any and all funds on deposit in the bank on the theory that the deposit is a *credit* and therefore subject to attachment?"

The case of *State ex rel Village of Warrensville Heights* vs. *Fulton, supra,* was an action in mandamus wherein the village sought to require the superintendent of banks, in charge of the liquidation of the Union Trust Company, Cleveland, to surrender bonds issued by the village and owned by the trust company, which had been pledged to secure a deposit of village funds in the trust company, under a contract made pursuant to sections 4295 and 4296, General Code. When the village sought to withdraw a portion of its deposit the trust company, and later the superintendent of banks, refused the demand on the ground that the trust company had the right to set off against the deposit two over-due notes issued by the village in anticipation of the levy and collection of special assessments, which notes were owned by the bank and aggregated a sum in excess of the amount on deposit.

The deposit, in one general account, consisted of funds derived from the following sources: The motor vehicle license fund, the gasoline tax fund, the general bond retirement fund, the special assessment bond retirement fund, various construction funds and the depository interest fund. The village contended that under Article XII, section 5, Ohio Constitution, and certain sections of the General Code, the tax funds on deposit were appropriated only for the specific purposes for which they were collected and hence their use in any other way would constitute an unlawful misapplication. It follows from this position that the bank's right to set off its notes would be limited to that part of the deposit collected for the purpose of paying the notes.

In rejecting the contention of the village, the court held, as disclosed by the syllabus:

"1. Public funds of a municipality derived from taxation, when deposited in a general account in a bank according to law under a depository agreement, lose their identity and become a part of the general funds of the bank.

2. The ordinary relationship of debtor and creditor is thereby created between the bank and the municipality, and the rights of the municipality are no greater and no different from those of an individual depositor.

3. Where the municipality is indebted to the bank on a past due obligation, the bank may properly apply such deposit against such indebtedness, upon the principle of set-off.

4. In the situation last described, when the state superintendent of banks takes over such bank for liquidation, the municipality is not entitled to a writ of mandamus to compel such superintendent to deliver to it the securities pledged by the bank to secure the public funds of the municipality deposited in the bank under a depository agreement."

Your first question is whether this decision abrogates the statutory restrictions imposed upon the use by the village of various funds when they are deposited in a bank. Stated concretely, your inquiry is whether a village, having all its funds on deposit in a bank, can use its gasoline tax fund or its special assessment bond retirement fund to pay the general obligations of the municipality. Omitting from consideration the possibility of transfers from one fund to another, I do not hesitate to answer this inquiry in the negative. The reasoning employed in the *Warrensville* case in nowise supports a contrary conclusion.

Section 11319, General Code, provides:

"A set-off is a cause of action existing in favor of a defendant against a plaintiff between whom a several judgment might be had in the action, and arising on contract or ascertained by the decision of a court. It can be pleaded only in an action founded on contract."

Section 11321, General Code, reads:

"When cross-demands have existed between persons under such circumstances that if one had brought an action against the other a counter-claim or set-off could have been set up, neither can be deprived of the benefit thereof by assignment by the other, or by his death. The two demands must be deemed compensated so far as they equal each other."

The following quotation from 5 *Ohio Jurisprudence,* 456, appears in the court's opinion at pp. 197, 198:

"Ohio statutes secure the right of set-off between parties sustaining the relation of debtor and creditor between whom there are cross-demands, and those existing between banks and their customers are not excepted from its operation. A bank may, therefore, apply a deposit of its debtor, or such portion thereof as may be necessary, to the payment of the debt due."

Section 4295, General Code, authorizes a municipality to "provide by ordinance for the deposit of all public moneys coming into the hands of the treasurer." Section 4296 contains further provisions regarding the creation of a municipal depository.

As pointed out in the *Warrensville* case, where the state or a political subdivision thereof deposits public funds in a bank pursuant to the applicable depository statute, the relationship of debtor and creditor is created. Thus, since the deposit is general in character, it may be used by the bank as part of its

general funds. *Fidelity & Casualty Co.* vs. *Union Savings Bank Co.*, 119 O. S., 124; *Ward, Treas.* vs. *Fulton, Superintendent of Banks*, 125 O. S., 382. It was held in these cases that upon liquidation of the bank, the public depositors were not entitled to priority of payment, the applicable depository statutes having been observed.

Since the relationship of debtor and creditor was created by the deposit, the rights of the village as between it and the bank were no different from those of an individual depositor, and therefore the bank had the right to set-off the deposit against the debt due from the village to the bank. The right of the bank must be distinguished from the power of the village officers who handle its funds. As far as the bank is concerned, when a legal deposit of public funds is made, the bank owes a debt to the public depositor which it can set off. The bank is not bound to inquire the source of the moneys deposited or the limitations placed by law upon the village officers in their use. In an ordinary deposit in a bank, either of private or public funds, the money is not earmarked. The duty of the bank as depository is discharged when the funds are withdrawn by the treasurer of the village. By no means does it follow that when village funds are deposited in a bank, the officers of the municipality are thereby relieved from observing statutory restrictions imposed upon the use of various funds created for specific purposes. See Opinions of the Attorney General, 1927. Vol. IV, p. 2717.

Your second question concerns the rights of special assessment bondholders, where such special assessments, pledged for the payment of their bonds, have been collected and the proceeds deposited in a duly constituted depository and applied upon a note owned by it and issued by the city. The specific question of the solicitor is what is he to say to these bondholders regarding the effect of the *Warrensville* case. He can say that as a result of this decision the entire amount of the deposit of the village, including the proceeds of these bonds, may be set off by the bank against any indebtedness of the village to the bank which is past due.

I am not advised whether there are funds available which might be transferred to meet the deficiency caused by the set-off under the provisions of section 5625-13, General Code. In this connection I direct your attention to an opinion of this office, reported in Opinions of the Attorney General, 1933, Vol. 1, p. 658, where it was held, as disclosed by the syllabus:

> "Moneys may be transferred from the general fund of a subdivision to the sinking fund or the bond retirement fund to meet a deficiency in either of the latter funds."

See also Opinions of the Attorney General, 1933, Vol. 1, p. 601; Opinions of the Attorney General, 1933, Vol. 1, p. 650.

The solicitor who submitted the inquiry is no doubt familiar with the limitations upon and possibilities of transfers from one fund to another and has knowledge of the availability of money which might be transferred for the benefit of the bondholders in question.

As I understand the third question presented, the solicitor desires to know how a depository bank's right of set-off can be limited to funds other than those collected for the payment of bonds. It is suggested that each fund might be carried in a separate bank account with an express agreement on the part of the bank that the bond retirement fund or sinking fund should not be subject to set-off.

A distinction should be noted between term bonds issued prior to January 1, 1922, and serial bonds issued subsequent to that date. Sections 4506 et seq., General Code, relate to the sinking fund and the sinking fund trustees. Section 4515, General Code, as amended by H. B. No. 55, 90th General Assembly, Second Special Session, reads:

> "At least once every three years the trustees of the sinking fund shall advertise for proposals for the deposit of all sums held in reserve and shall deposit such reserve in the bank or banks, incorporated under the laws of this state or of the United States, situated within the county, which offer, at competitive bidding, the highest rate of interest and best security and accommodation and give a good and sufficient bond issued by a surety company authorized to do business in this state, or furnish good and sufficient surety in a sum not less than twenty per cent in excess of the difference between the maximum amount at any time to be deposited, and such portion or amount thereof as shall at any time be insured by the federal deposit insurance corporation created pursuant to the act of congress known as the banking act of 1933, or by any other agency or instrumentality of the federal government pursuant to said act or to any acts of congress amendatory thereof. There shall not be deposited in any one bank an amount in excess of the paid-in capital stock and surplus of such bank, or to exceed in amount one million five hundred thousand dollars except when such moneys are deposited for the purpose of meeting the payment of some obligation."

Section 4516 contains further provisions with relation to the depository contracts of sinking fund trustees.

Section 4516-1, General Code, reads:

> "The provisions of section 4515 and 4516 of the general code shall not apply where sums held in reserve, by trustees of the sinking fund, are deposited in the city treasury, so as to become part of the general city balance to be deposited in banks as otherwise provided by law."

Section 2295-14, General Code, provides that the board of sinking fund trustees shall continue to exercise the powers and duties imposed by the various provisions of law relating to it, until all outstanding bonds of the subdivision issued previous to January 1, 1922, have been paid. That section further provides:

> " * * * Thereafter all said moneys, securities and assets and all moneys received by the county, municipality or school district for the payment of the interest and principal of its bonds or other funded debts, and all inheritance taxes and all other taxes and revenues which were theretofore payable, by virtue of provisions of law, into its sinking fund shall be paid to its treasurer and placed and held by him in a separate fund to be known as 'bond payment fund' and, subject to the provisions of law relating to transfer to other funds, said fund shall be applied by him to the purposes for which the sinking fund had theretofore been applicable."

See Opinions of the Attorney General for 1927, Vol. IV, p. 2717.

It is apparent that moneys for the payment of serial bonds issued after January 1, 1922, are paid to the village treasurer. Furthermore, under favor of section 4516-1, General Code, sums held in reserve by the trustees of the sinking fund for the payment of term bonds issued prior to January 1, 1922, may come into the custody of the municipal treasurer as part of the general balance of the subdivision. Funds in the custody of the treasurer for the payment of serial bonds and those in his custody under section 4516-1, General Code, may be deposited along with other moneys of the village in a bank.

If these funds are deposited in a bank under sections 4295 (amended, H. B. No. 55, 2nd Special Session, 90th General Assembly), and section 4296, General Code, the treasurer and his bondsmen are relieved from liability for loss. As above noted, when public funds are deposited under such a depository statute, the relationship of ordinary debtor and creditor is established. I find no authority in these sections for establishing a special deposit for a special purpose as to any class of funds of the village, which would result in defeating the bank's right of set-off and also give to the municipality a right of preference over other creditors in case it could identify a trust corpus.

Public officers have only those powers expressly authorized by statute, together with such implied powers as are necessary to effectuate those expressly granted. *State ex rel* vs. *Pierce,* 96 O. S., 44; *Schwing* vs. *McClure,* 120 O. S., 335. It follows from this principle that if a depository is created under sections 4295 and 4296, General Code, the only method of creating a depository by which the treasurer and his bondsmen can be relieved of liability, the provisions of the statute must be strictly observed. Since these provisions do not authorize special deposits, compliance with them of necessity constitutes the bank a debtor as to all funds of the village deposited under the contract.

Moneys deposited by the board of sinking fund trustees under sections 4515 and 4516, General Code, while creating a debtor and creditor relationship, stand in a different light. In my opinion a bank could not set off such deposits against a debt due it from the village. Under such a depository contract the bank's creditor would be the board of sinking fund trustees rather than the village. Funds so deposited are not part of the "general city balance" as are those deposited in the city treasury under section 4516-1, General Code, and in turn deposited in a bank under sections 4295 and 4296, General Code. While I find no cases directly in point governing, this conclusion appears to me to follow from the numerous cases denying the right of set-off on the ground of lack of mutuality. Corporate stockholders may not set off individual demands against a debt due from the corporation. *Gallagher* vs. *Germania Brewing Co.,* 53 Minnesota, 214. It has been held that an insolvent owner of all the stock of a corporation cannot set off his personal debt to an insolvent bank against a deposit therein of the corporation. *Taub* vs. *Koker,* 161 S. E., 117 (S. C.). The following statement appears in 1 Morse, Banks and Banking, 760 (6th Ed.):

> "The lien and the right of set-off only exists where the individual, who is both depositor and debtor, stands in both these characters in precisely the same footing towards the bank. * * *"

In my opinion a debt due from the bank to the board of sinking fund trustees, and a debt due from the village to the bank, cannot be considered cross demands existing in the same right, subject to be set off. There is a lack of mutuality in such obligations.

It is probably unnecessary to point out that the language of section 4295 is permissive. The bank's right of set-off could, of course, be defeated by not creating a depository. No doubt this is by no means a desirable or practical solution to the problem.

Section 12873, General Code, standing alone, would constitute a treasurer of a municipality, depositing funds in a bank, an embezzler. Section 12875 provides that such section "shall not make it unlawful for the treasurer of a * * * municipal corporation * * * to deposit public money" in a bank but does not release him from civil liability for loss which may occur thereby.

Section 4294, General Code, reads:

> "Upon giving bond as required by council, the treasurer may, by and with the consent of his bondsmen, deposit all funds and public moneys of which he has charge in such bank or banks, situated within the county, which may seem best for the protection of such funds, and such deposit shall be subject at all times to the warrants and orders of the treasurer required by law to be drawn. All profits arising from such deposit or deposits shall inure to the benefit of the funds. Such deposit shall in no wise release the treasurer from liability for any loss which may occur thereby."

In the case of *In re Liquidation of Osborn Bank*, 1 O. A., 140, after quoting this section the court said at pages 143-144:

> "* * We hold that Section 4294 is consistent with and is intended only to legalize *special deposits*. Like Section 12875, the civil liability of the treasurer upon his bond is retained, and there is nothing to warrant the inference that the treasurer's duty or authority over the trust funds was to be vitally changed. The treasurer had no authority to convert the funds to his own use and it follows that he had no authority to authorize another to do so.
>
> It is true that Section 4294 contains the provision that all profits upon deposits shall inure to the benefit of the fund. This was intended, in our judgment, not as a license but as a precaution. There were undoubtedly cases when profits on deposits were allowed and paid public treasurers, and the legislature by this provision intended to fix the public policy with reference thereto. As a part of this act the depositary law was provided. In this and all other depositary laws there are stringent safeguards thrown about the general deposit and investment of the public funds. Care is taken as to the amount of interest and the nature of the special security to be given, and it is inconceivable that the entire body of the fund was intended to be authorized to be embarked in speculation or investment upon the sole authority of the treasurer and his general bondsmen."

The court in this case held that village funds deposited without complying with sections 4295 and 4296, General Code, were special deposits and as such entitled to priority of payment upon liquidation. Since the bank is not a debtor under such circumstances, it would have no right of set-off. A special deposit created in this manner is generally referred to in preference cases as an "illegal deposit." In view of the language used by the court in the *Osborn Bank* case, I

cannot recommend, in order to avoid the bank's right of set-off, that the village treasurer attempt to create a special deposit under section 4294, General Code.

Your last question is whether creditors, who have obtained judgments against the village in actions for damages, have the right to resort to any and all funds on deposit in a depository bank by way of proceedings in aid of execution, on the theory that the deposit is a "credit."

The following statement appears in 17 O. Jur., Sec. 284, p. 888:

> "In Ohio, although writs of execution may be issued against municipal corporations, it has been held, on grounds of public policy, that property which cannot be taken without interfering with the discharge of public functions on the part of the municipal body is not subject to levy of execution. On the other hand, it is said that property of a city, held by it for income or for the purposes of sale, or not connected with the discharge of municipal functions, may be subjected to levy. However, in applying this distinction, the tendency of the courts has been to hold property within the former category. Thus, actual use of the property by the city apparently is not necessary to exempt it from execution."

The cases of *Cincinnati* vs. *Frost, Stearns & Co.,* 8 Dec. Rep., 108, and *Cincinnati* vs. *Cameron,* 6 Dec. Rep., 727, 6 Bull. 75, are cited in support of the statements in the text. In the latter case it was held that property of a municipal corporation, devoted to public purposes, is exempt from execution, although not presently so used.

If property devoted to public purposes is not subject to execution, surely similar property may not be taken on proceedings in aid of execution. A bank credit representing the deposit of funds collected for the payment of bonds is certainly property devoted to a public purpose. It follows that a judgment creditor cannot resort to it in order to satisfy his debt. If such judgment creditor owed a debt to the city, he could compel a set-off under the doctrine of the *Warrensville* case. That is not the situation presented by your question.

In view of the foregoing, it is my opinion that:

1. Although a depository bank has the right to set off a debt which it owes, arising by virtue of a lawful deposit of village funds derived from taxation, without regard to the source of the funds on deposit, or the statutory limitations upon their expenditure, against a debt due from the village to the bank, it does not follow from a court decision recognizing such right that a village can use any and all of its funds legally on deposit for any and all public purposes, without regard to the statutory restrictions upon the use of different classes of funds. *State ex rel Village of Warrensville Heights* vs. *Fulton,* 128 O. S., 192, discussed.

2. Under section 5625-13, General Code, moneys may be transferred from the general fund of a subdivision to the sinking fund or bond retirement fund to meet a deficiency in either of the latter funds. Opinions of the Attorney General, 1933, Vol. 1, p. 648, approved and followed.

3. A depository contract, made in accordance with sections 4295 and 4296, General Code, necessarily creates the relationship of debtor and creditor, there being no authority for drawing such contract so as to create a trust or bailment relationship in order to defeat or limit the bank's right of set-off.

4. Moneys in the sinking fund of a village, deposited by the sinking fund trustees under sections 4515 and 4516, General Code, may not be set off by the bank against a debt due it from the village.

5. Sinking fund moneys in the custody of the village treasurer, under section 4516-1, General Code, as part of the general balance of the subdivision, and deposited by him in the municipal depository by virtue of sections 4295 and 4296, General Code, are subject to the bank's right of set-off against a debt due it from the village.

6. If funds, constituting part of the general village balance, are deposited in a bank in any manner other than that prescribed by sections 4295 and 4296, General Code, and if the bank, at the time such funds are received, has knowledge of their public character, a special deposit is created, which the bank may not set off against a debt due from the village to the bank.

7. A judgment creditor of a village can not resort to a bank credit of the village, which represents the deposit of funds collected for the payment of bonds or notes issued by the village, in order to satisfy his judgment.

Respectfully,
JOHN W. BRICKER,
Attorney General.

2867.

APPROVAL, BONDS OF THE CITY OF TOLEDO, LUCAS COUNTY, OHIO—$25,000.00.

COLUMBUS, OHIO, June 28, 1934.

Retirement Board, State Teachers Retirement System, Columbus, Ohio.

2868.

APPROVAL, BONDS OF NEWTON FALLS EXEMPTED VILLAGE SCHOOL DISTRICT, TRUMBULL COUNTY, OHIO—$15,000.00.

COLUMBUS, OHIO, June 28, 1934.

Retirement Board, State Teachers Retirement System, Columbus, Ohio.

2869.

APPROVAL, BONDS OF LAKEWOOD CITY SCHOOL DISTRICT, CUYAHOGA COUNTY, OHIO—$31,000.00.

COLUMBUS, OHIO, June 28, 1934.

Retirement Board, State Teachers Retirement System, Columbus, Ohio.