the effort to incite the people to pull down about their own ears the fabric of the government, in the effort to produce a condition of "harmony," that they are at liberty to secure a continent, or if that be too small, a separate hemisphere of their own.

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## DEPARTMENT OF PRACTICE, PLEADING AND EVIDENCE.

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MELVIN ET AL. *v.* ALDRIDGE ET AL.[1] COURT OF APPEALS OF MARYLAND. June 18, 1895.

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In an action for an accounting, between owners of property and their agents for its sale, a personal indebtedness of one of the owners to one of the agents cannot be considered, "that," in the words of FOWLER, J., "being a transaction between them and him, in which the other defendants are in no wise interested."

### SET-OFF BY AGENT AGAINST PRINCIPAL.

When, in the course of the agency, money belonging to the principal has come into the agent's hands, and the principal makes a demand upon him for an accounting, or return of the money, under what circumstances, if ever, can the agent set up, in reply, that a debt is due him from the principal?

It is said that "the right of set-off, recoupment and counterclaim, in actions at law between principal and agent, is governed ordinarily by the same rules that apply in other cases. This right, however, may be waived by contract, express or implied, and it cannot be insisted upon where its enforcement would result in a violation of the agent's duty to his principal:" *Mechem on Agency*, § 535.

[1] Reported, 32 Atl. Rep. 389.

The general right of agents to retain, out of money in their hands, compensation for their services in the same transaction, is unquestionable; and a discussion of claims by way of commissions, or otherwise, and their enforcement through the medium of liens, is beyond the present purpose.

The agent's right to reimbursement for expenses or losses necessarily incurred in and about the transactions of the agency seems equally well settled: *Story on Agency*, Cap. 13; *Wharton on Agency*, Cap. 5; *Waterman on Set-off*, Cap. 3.

As to the right of an agent to set-off, in an action by his principal, a debt arising prior to the inception of the relation, or during its subsistence, but independently thereof, there is some room for discussion; but the law appears to be reducible to the following propositions:

I. When money is entrusted to an agent directly by the principal, or is collected or received for the principal, and there is an antecedent appropriation of the funds to specific purposes, by his express direction, it is held that the agent has no more right to divert the funds from their destination by appropriating them to the payment of his own debt, than he has to divert them for any other purpose.

"The receipt of money for a defined use amounts to an agreement, on the part of the person receiving it, that he will not apply it to any other, and, of course, not to his own, by pleading a set-off:" *Smuller v. Union Canal Co.*, 37 Pa. 68 (1860); See, also, *Ardesco Oil Co.* v. *North American Oil Co.*, 66 Pa. 375.

The fiduciary relationship, usually said to exist, is, in this instance, made concrete, and the agent is a trustee upon a special trust, actually, if not technically.

In *Tagg* v. *Bowman*, 108 Penna. 273 (1883), which is, perhaps, the leading case, an agent was authorized to make certain collections, and apply the money, first, to the payment of debts due to third persons, and then to a debt due to himself, but instead, applied the whole amount to his own debt. In an action by the principal for the amount collected, the agent's claim to set-off his debt was disallowed, the court saying that the money, as collected, belonged to the principal,

and as it came into the agent's hands was impressed with a trust in favor of the principal, which required its application to the objects specified, in their order. So long as there was anything due upon the preferred objects, the agent had no right to appropriate any of the money to the payment of his own claim, for such appropriation would be a manifest breach of the trust on which it was received.

Where a State government deposited money in a bank, giving notice that the fund was to be devoted to a specific purpose, viz.: the building of a canal, it was held that the bank could not set-off, as a defence to the demand upon coupons payable out of said fund, a balance due by the State, for an overdraft of its general account: *Bank of the United States* v. *MacAlester*, 9 Penna. 475 (1848). The court said: "As long as the deposit is permitted to remain in their hands, they are the agents of the holders of the coupons to the amount of the fund set apart for their payment. It would be a culpable breach of trust to appropriate the fund to any other purpose, and especially to apply it to their own use:" See, also, *Weston* v. *Barker*, 12 Johns, 276; *Dias* v. *Brunells' Exr.*, 24 Wend. 9. But, see, *Pendergast* v. *Greenfield*, 40 Hun. 494.

In a case where the collector of a canal company received sums as tolls, which it was his express official duty to apply towards the payment of a certain claim against the company, it was held that he could not set-off in a suit by the company for an accounting, a note held by him against the company: *Smuller* v. *Union Canal Co.*, 37 Penna. 68 (1860). The money being appropriated before it came into his hands, he was constituted the agent of the company for the express purpose of paying it over to the specified persons, and could not appropriate any part of it to his own debt.

The same conclusion was reached in a case where a corporation placed money in the hands of its general manager "for safe-keeping, and to be disbursed in its business:" *First National Bank of Detroit* v. *Barnum Wire and Iron Works*, 58 Mich. 124 (1885). See, also, *Peters* v. *Nashville Savings Bank*, 86 Tenn. 224.

The consideration of these last cases leads to the next proposition.

II. The receipt of money *in an official capacity—e. g.*—as treasurer of a corporation—would seem to be equivalent to an antecedent express appropriation to the purposes of the office.

Thus, where the treasurer of a church was sued by the church for funds in his hands, it was held that he could not set-off a debt due him in his individual capacity, SHARSWOOD, J., saying: "He received the funds to hold at the order of the corporation, as their officer, and without such order he cannot pay or appropriate them either to himself or others. There is fairly to be implied, from the relation he sustains, an undertaking not to plead a set-off, but to account and pay over whatever money came to his hands in that character:" *Russell* v. *First Presbyterian Church*, 65 Penna. 9 (1870).

In *Middleton and Harrisburg Turnpike Road Co.* v. *Watson*, 1 Rawle, 330 (1829), the manager and agent of the company had made collections from delinquent subscribers, and, in a suit against his administratrix by the company to recover this money, the defence relied on was that the money had been expended in the purchase of the debts of the company. This was overruled, the court saying: "The relation of principal and agent is well settled; as long as the agent acts within the scope of his authority, and no longer, he is protected. It was the duty of Watson to collect and pay over the funds as they came to his hands. It was for the company to direct the application of the money, when in the treasury, or under their control, to whatever purposes they might suppose most beneficial to the corporation. This they have been prevented from doing, by an assumption of power by their agent, and a misapplication of the funds of the company. . . A principal may give special authority to his agent to settle and liquidate his debts, and this is frequently done; but previous to the introduction of such a defence, to a suit brought for money had and received as agent, the special authority should be shown."

The treasurer of a borough was not allowed to set-off, in the settlement of his accounts, a bond held by him for money

loaned to the borongh: *Todd* v. *Borough of Patterson*, 55 Pa. 496 (1867). It was held that the subject of the settlement must be his official receipts and disbursements, and that he was chargeable with money coming into the treasury by way of loan, whether from himself or others. "As treasurer, he could not know what reason the council might have for refusing payment; and he could not, by his own act, determine any defence the council might have, in his own favor, as the holder of the bond. The sum of the matter is, that, as an officer, he could not obtain a credit for the disbursement to the bond held by himself as an unofficial person; in short, without an order of council. He could neither deprive the borough of its defence, nor speculate in his official capacity upon the claim preferred against it. . . As treasurer, the case was rightly decided against him. As a creditor of the borough, he can proceed as any other creditors may do, if the debts be valid." See, also, *Prewett* v. *Marsh*, 1 Stewart & Pater, 17; *Harper* v. *Howard*, 3 Ala. 284; *Wilson* v. *Lewistown*, 1 Watts & Serg. 428; *Com.* v. *Rodes*, 5 Mont. 318; *Waterman on Set-off*, § 190.

III. Where, then, the relationship is such that the funds are held upon a trust for specific purposes, the rule seems to be well settled.

It is hornbook law that a trustee cannot, on the subject of the trust, act for his own benefit, to his principal's detriment. See *Parkist* v. *Alexander*, 1 Johns. Ch. 394; *Story on Agency*, Cap. IV., etc., etc.

Furthermore, it is a fundamental principle of the doctrine of set-off, that the debts as to which the right is claimed must be due in the same capacity.

Against a claim for a debt due by a trustee in his fiduciary capacity, he cannot set-off a debt due to him individually: *Tagg* v. *Bowman*, 99 Pa. 376 (1882); *First Natl. Bank of Detroit* v. *Barnum Wire Works*, 58 Mich. 124 (1885); *Scammon* v. *Kimball*, 92 U. S. 362; *Daniel* v. *Wall*, 4 S. E. 271 (Ga. 1888); *Shearman* v. *Morris*, 24 Atl. 313 (Pa. 1892); *Sticking* v. *Clement*, 7 Gray 170; *Richbourg* v. *Richbourg*, 1 Harp. Eq. (S. Car.) 168; *Bradshaw's Appeal*, 3 Grant, 109, and other cases too numerous for citation.

But, although the relation of principal and agent is, in general language, said to be a fiduciary one, yet it is not invariably so, in all senses. In *Spalding* v. *Mattingly et al.*, 1 S. W. 488 (Ky. 1886) it was said: "The equitable rule which prevents an agent from dealing with his principal's property for his own benefit, inconsistent with the interest of the principal, applies only to agents who are relied upon for counsel and direction, and whose employment is rather a trust than a service, or both, and not to those who are employed merely as instruments in the performance of an appointed service."

IV. As to the case where an agent makes a collection, sells goods, or receives money on deposit from the principal, and there it neither an express appropriation of the funds, nor an official position and duty, the authorities are not in harmony, and no general rule can be laid down.

Agents, as to this subject, may be divided into three classes: (1) Attorneys, or other agents, who make collections for their principals; (2) Bankers, or others, receiving money on general deposit; (3) Factors and brokers, who sell goods of their principals and receive the price.

The general rule applies to all these classes, that "the agent is bound to account to his principal for all money and property which may come into his hands during and by virtue of the agency:" *Mechem*, § 522.

And "an agent authorized to collect and transmit funds to his principal, has no implied authority to enter into any contract concerning the money in his hands:" *Mechem*, § 384.

Does this general duty to account and transmit amount to such a destination of the money as to prevent the agent from setting-off his individual debt?

The only authorities which are to be found, are not conclusive of the question.

On the one hand, it has been held, in Indiana, that, where an attorney was sued for money collected, he might set-off a note held by him, executed by his client: *Noble* v. *Leary*, 37 Ind. 186 (1871). It having been argued that, on account of the existence of the relation of principal and agent, the attorney could not purchase the note and set it off, the court

said: "The appellee deduces this principle from the rule that the agent cannot place himself in a position adverse, or in opposition to the interest of the principal. We have not found any case exactly like this. Recurring, however, to the works on the subject of agency, we find the rule to be this, that, in matters touching the agency, agents cannot act so as to bind their principals, where they have an adverse interest: *Story*, § 210. The purchase of the note in this case, was, so far as we can see, in no way connected with the agency. We see no reason why, if the defendant had sued on the note which he purchased, [the client] could not have met the claim by an answer of set-off, on account of the liability of the defendant to him for the money collected. Nor can we, on the other hand, see any legal reason why, when [the client] sues the defendant for the money collected, he cannot use the note as a set-off, to that extent, against the demand for the money. . . . It is not claimed that there is anything in the nature of this particular agency which requires it to be distinguished from any other agency; but it is insisted that the rule contended for applies to all agencies where it is the duty of the agent to account for money received by him for his principal. Could it be successfully asserted that the defendant could not have sued on the note, even while he yet held the money collected for him in his hands? We think not."

Whether the conclusion here reached be correct or not, the reasoning is obviously bad. There is a confusion of thought, in arguing as though the agent's alleged breach of duty lay in his purchase of the note, and not in his endeavor to use it in a particular way. There is a *petitio principii* in assuming that the client would have had the right to set-off the claim for money collected, in a suit on the note. And, finally, there is an error of law in the proposition that, because the holder of the note would have had a right to bring suit upon it, he must, therefore have had the right to set it off.

On the other side is the Pennsylvania case of *Simpson* v. *Pinkerton et al.*, 10 W. N. C. 423 (1881), where an attorney who had collected a claim for damages to real property, was not allowed to set-off against a claim for this amount, a sum

due him by the owner of the property on bonds and coupons secured by a mortgage on the same property.

The opinion was *per curiam*, the court saying only: "We think it is very clear that an attorney-at-law, or in fact, employed to collect a claim, when he has received or recovered the money, has no right to set-off an antecedent debt or claim in his own right against his constituent. He ought to show in such case that his constituent expressly agreed that he might retain his demand out of the money." This certainly seems more in harmony with the whole theory of the subject.

In the case of *Reed* v. *Penrose's Executrix*, 36 Pa. 214 (1860), funds of a corporation had been deposited by the treasurer with a banker, who was also the president of the corporation, under an agreement to pay interest and to hold the money subject to call. On attachment-execution against the company, the banker was made garnishee, and sought to set-off bonds of the company held by him. The court below held that this could not be allowed, and the judgment was affirmed on other grounds, without any opinion of the majority of the court on this point.

In the subsequent case of *Fox et al.* v. *Reed*, 3 Grant, 81, involving substantially the same set of facts, the Supreme Court held that, as against third parties, the set-off was rightly refused the court saying: "It would be a breach of the confidence reposed in him as depositary, as president, and as co-corporator, for him to take such an advantage of his position."

Yet the opinion of STRONG, J., in the former case, remains of interest and value. He maintained that the set-off should have been permitted, saying: "This right of defalcation is a legal right, secured to a defendant in all cases where he holds demands against a plaintiff, due in the same right, and due at the time when the suit was commenced against him. I agree that he may, by express contract, preclude himself from pleading a set-off. Such a contract, founded on consideration, would bind him. . . And I think a defendant may also debar himself from using a set-off by a contract not express. Thus, if he receives money delivered to him for his application to a particular use, his receipt may amount to an agreement

not to apply it to any other use, and of course not to his own, by pleading a set-off. The case of *Bank* v. *Macalester* [*supra*], goes no further than this. But, while I admit that a defendant may bar himself from using a set-off by contract, either express or implied, I deny that he can be deprived of his legal right to defalcate, by anything less than a contract. In the present case there is no allegation of any express contract not to plead a set-off. The only question, therefore, is whether one is to be inferred from the transactions between the debtor and garnishee. It is hardly necessary to say that it is not to be implied from the intention or expectation of the creditor at the time when the debt due him was created, nor from the inconvenience to which he may be subjected if the set-off be allowed. . . No doubt the company had no expectation that the president would retain the funds deposited with him under any claim of set-off. No doubt his having done so would have embarrassed them, but they exacted no agreement from him not to plead it; they relied upon what was at most an honorary obligation. He was the banker of the company and received the money in the ordinary course of business as a banker. But is a banker bound to answer the checks of a depositor when he holds the depositor's notes or bonds part due? The contrary has been held again and again: *Davis* v. *Bowsher*, 5 T. R. 492; *Rogerson* v. *Ladbroke*, 1 Bing. 94; *Bank* v. *Armstrong*, 4 Dev. 524; *Albany Commercial Bank* v. *Hughes*, 17 Wend. 94.

Nor is there anything in the receipts which R. signed, from which can be inferred a promise not to defalcate. Most of them are mere acknowledgments, that sums of money, being canal funds, had come to his hands, "to be accounted for when required." Is that anything more than a promise to pay on demand? One recites that the sum received was the amount appropriated by said company for rebuilding [certain] aqueducts, upon which he was to pay interest until called for. This is a mere description of the ownership of the fund, and an identification of it. It was not itself an appropriation, not a receipt by the banker for the purpose designated, as was the case in *Bank* v. *Macalester*. Reed as banker had nothing to

do with its appropriation, assumed no agency for any such purpose. His only engagement was to pay the company. Of course, then, there having been no stipulated use, he was free to use the set-off. . . . His presidency did not prevent his making any contract with the company, and he did contract as banker. . . . I have failed to discover any evidence of a contract, express or implied, that the garnishee would not plead the statute of defalcation, and I cannot but think that a denial to him of the right of set-off is enforcing what is only an honorary obligation in a court of law. . . . I repeat that set-off is a legal right, and, though it may be waived, no one can be compelled to waive it, except by the force of his own contract. And this contract must be positive and unequivocal. . . . Of course, I am not speaking of cases of fraud, nor of those peculiar and technical trusts cognizable only in a court of equity, in opposition to which, set-off can never avail. This is no such case."

It is enough to say that the rule stated, as to bankers, is undoubtedly correct. The subject is not one for discussion in this place.

The class of agents embracing factors and brokers, who have custody of the property of the principal, presents some interesting questions.

The general rule seems to be, that "factors, agents and brokers acting as such, and having the custody of money or property belonging to a principal, act in a fiduciary capacity, and are for that reason held to a strict liability:" *Edwards on Bailments*, § 184, and cases.

It may be well to premise, that, whatever rights of set-off such agents may have, they cannot be enforced through the medium of liens. The factor's or broker's lien "does not extend to other independent debts contracted before and without reference to the agency:" *Story on Agency*, § 376; *Wharton on Agency*, §§ 768, 818; *Mechem on Agency*, § 1032, and cases cited; *Drinkwater* v. *Goodwin*, Cowp. 251; *Houghton* v. *Matheus*, 3 Bos. & P. 485; *Ex parte Shank*, 1 Ark. 234; *Walker* v. *Buck*, 6 T. R. 258; *Nudd* v. *Burrows*, 91 U. S. 426; *Stevens* v. *Robins*, 12 Mass. 182.

"Though a factor may sell and bind his principal, he cannot pledge the goods as a security for his own debt:" 2 Kent Com. 625, and cases cited; *Mechem*, § 324, and cases cited.

"The factor cannot confer title, even upon a *bona fide* holder, by turning out the principal's goods in payment of his own debts, even though the accounts between the principal and the factor may be in the factor's favor; *Mechem*, § 996; *Benny* v. *Rhodes*, 18 Md. 147; *Holton* v. *Smith*, 7 N. H. 446; *Warner* v. *Martin*, 11 How. (U. S.) 209.

In *Key et al.* v. *Flint*, 8 Taunt. 21 (1817), A, previous to bankruptcy, deposited a bill of exchange with B, not upon his general account, but for the specific purpose of raising money thereon. In trover by his assignees, they having tendered the amount advanced, it was held that B could not set-off the amount due him on the general balance.

DALLAS, J., held that this was not a case of "mutual credits" within the bankrupt law (5 Geo. 2, c. 30), saying: "Mutual credit must mean mutual trust; and this attempt of the defendant appears to me a gross breach of trust. The bill of exchange which forms the subject of the present action was entrusted to the defendant for a specific purpose, with an express understanding that it was not to go into the general account." See, also, *Buchanan et al.* v. *Findlay et al.*, 9 B. & C. 738 (1829), and cases there cited, under the same statute.

The case of *McGillivray* v. *Simpson*, unreported, but given in a note to 9 B. & C. 746, was an action against a broker for the proceeds of some timber sold by him on account of bankrupts. It appeared that the timber was placed in his hands for sale, upon his promising to pay over the proceeds, deducting his commissions. The defendant sold the timber, and then claimed to retain out of it a debt due him from the bankrupts; and it was held that he might do so. This case is cited with approval by Lord TENTERDEN in *Buchanan* v. *Findlay*, *supra*, and seems to be the only decision extant on the precise point.

It was, to be sure, a decision under the express provisions of a statute, but these were simply, that, when there had been mutual credits or mutual debts between the bankrupt and any other person, one debt might be set-off against the other:

5 Geo. 2, c. 30, § 28. And "the same mutuality of credit is required in the case of setting off credits under the bankruptcy laws, as is required in order that debts may be set-off under the ordinary statutes of set-off": 22 *American and English Cyclopædia*, 265, *Tit. Set-off;* 8 Bac. Abr. 651; *Staniforth* v. *Fellows*, 1 Marsh. 184.

In a recent case, where the plaintiff had entrusted horses to the defendant to sell at auction, it was held, in an action for their price, that the defendant could not set-off damages caused by one of the horses running away and injuring property of a third person: *Oberholtzer* v. *Heist*, 16 Atl. 804 (Pa. 1889).

V. In jurisdictions where the right of set-off is confined to items growing out of the contract or transaction on which suit is brought, the agent's right will of course be limited.

Thus, where the defendant, having acted as agent for the plaintiff, in the sale of certain goods, gave his note for the balance due upon a settlement of their accounts, in action on the note, he was held entitled to set-off against it only the amount due him by plaintiff as commissions on sales made by him, and not commissions for other acts, such as collections: *Jackson* v. *Tate*, 2 South. 97 (Ala. 1887). See, also, *Clark's Grove Guano Co.* v. *Appling*, 33 W. Va. 470 (1890).

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