THE APPLICATION OF MONEY WRONGFULLY PROCURED, BY A DEFAULTING AGENT OR TRUSTEE, TO THE PAYMENT OF THE DEBTS OF THE PRINCIPAL'S BUSINESS OR THE TRUST ESTATE.

Problems often arise in the determination of cases which cannot be settled by any definite and single principle. The common law, being a system of principles applicable to the general activities of men, this is frequently bound to occur. It is inconceivable that human foresight of court or legislature should prove adequate to cope with all possible future contingencies. This may not be a regrettable condition. Legislation represents but contemporaneous economic and social views. Judicial opinion, in providing for the future, leads to dicta, regarded as binding on none, and productive of harmful results. Fortunately the cautiousness of our judges makes this infrequent, though important examples are not wanting.¹

It is, therefore, not an unusual instance if it proves true of the problem, indicated by the somewhat voluminous title appearing above, that no certain rule of definite law can be called upon to decide it. To state the problem: May the owner of money or property, fraudulently secured or taken from him by one who is an agent or trustee managing the business or property of another, and by him, as such agent or trustee, devoted to the payment of the debts incurred in the business or the conduct of the trust, recover the same at law or in equity from the principal or the trust estate, the fraud-feasor being a defaulter in a larger amount? Whenever this, or closely analogous problems, have been presented, the result has been obtained by the application of general principles of law and not because of the bearing of any specific rule.

For the purpose of the investigation, it is thought that the

matter primarily divides itself into two separate discussions, each of which is in turn sub-divided into a treatment of the respective relationships of trustee and cestui que trust, and of principal and agent. The basis of the first division is one of fact. The essential facts of the hypothetical case raising the question, dealing for the present with agency alone, would be as follows: The agent is placed in charge of the business of his principal with full authority to do all things necessary to the complete management thereof; while so engaged he misappropriates property or money of the principal, and, in order to cover his defalcation, he steals or fraudulently secures from a third person, the plaintiff, money or property which he converts into money, and uses to pay the creditors of the business whose claims he should have discharged with the money embezzled; the agent then absconds and the plaintiff seeks to recover his property or its value from the principal, claiming that he has had the benefit of it and should repay.

Two different views may be taken of these facts. First, the agent used the money fraudulently secured to pay his debt to the principal, and thereafter immediately drew upon the principal's money in his hands to pay the debts of the business. Second, that the agent directly paid the debts of the business with the plaintiff's money. It is proposed, therefore, to approach the question from both standpoints and within each to treat both the relations of trust and of agency.

I.

A. Principal and Agent.

It is clear that, so long as the money of the plaintiff remained in the hands of the agent, it was the plaintiff's money. He could follow it and take it from the agent; and, so long as he could identify it or its product, he could claim a preference over the general creditors of the agent to the extent, at least, to which the latter had defrauded him. Did it cease to be the plaintiff's

"Following Misappropriated Property into its Product," by James Barr Ames. 19 Harv. L. Rev. 511. Re Hallett, 13 Ch. D. 696; Lehman v. Gunn, 124 Ala. 213; Holmes v. Gilman, 138 N. Y. 360. "It is now well settled that one who has been deprived of his property by fraud, by theft, or by any
money when the agent paid it in discharge of the obligation to his principal arising from his default? This must depend upon whether the principal is a purchaser for value without notice. If he is, the trust, attached to the specific money or property in favor of the plaintiff, is extinguished; and the principal, now the defendant, is free from any liability to the plaintiff, at law or in equity, unless some principle of law other than the doctrine of following trust monies can be invoked. If the principal is not in the situation of a purchaser for value without notice, the plaintiff may recover from him, subject only to one further qualification, that he cannot claim other than as a general creditor, unless he can now identify some specific property in the estate of the defendant as the product of his money, or at least show that the assets of the defendant have been swollen by the amount thereof. But, in any event he would be entitled to recover judgment for the amount of his property which had been received by the principal. What then is the exact position of the defendant?

It is clear that he is a holder for value, for the money was received, if it can be said to have been received by him at all, in payment of the pre-existing debt of the agent. But is he without legal notice? By hypothesis he is without actual notice, and therefore, if he is to be charged with constructive notice it must be because, by some rule of agency, he is charged with the notice his agent had at the time of the payment of the agent's debt to him. This makes necessary a consideration of those circumstances under which the knowledge of an agent in a particular transaction is imputed to the principal to charge him with notice of facts and countervailing equities known to the agent.

As a general proposition, it is well established that notice to

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wrongful conversion, may charge the fraudulent vendee, the thief, or other wrongful converter as a constructive trustee of any property received in exchange for the misappropriated property."

1 Taylor v. Blacklock, 32 Ch. D. 560; Wright v. Leys, 8 Ont. 88; Holly v. Protestant Episcopal Church, 180 U. S. 284 (1901); Whittle v. Vanderbilt Mining Co., 83 Fed. 48 (1897); Ruff’s Appeal, 100 Pa. 531.


4 Cases cited in notes 4 and 5.

an agent in a particular transaction is notice to the principal. This rule is made one of presumption. It is the affirmative duty of the agent to disclose to his principal all relevant facts coming to his knowledge in the course of the performance of his duty. And in case of a failure so to disclose material facts within his knowledge, the agent is liable to his principal for any loss-in consequence thereof. This is a duty which the law conclusively presumes that the agent has performed.

But if the circumstances are such that this presumption becomes an absurdity, the law rejects the presumption. So where the agent is engaged in a transaction in which he is interested adversely to his principal or engaged in a scheme to defraud the latter, so that it is certain the agent will not perform this duty, it is held that the principal will not be charged with the knowledge of the agent. The reason is stated to be that, where the communication of such a fact would necessarily prevent the consummation of a fraudulent scheme which the agent is engaged in perpetrating, a clear presumption is raised that he would not communicate that fact. A divergent reason for the exception also appears in Massachusetts. "The true reason for the exception is that an independent fraud committed by an agent on his own account is beyond the scope of his employment, and, therefore, knowledge of it, as a matter of law, cannot be imputed to

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9 Pringle v. Modern Woodmen of Amer., 113 N. W. 231 (Neb.); Dorr v. Camden, 46 S. E. 1014 (W. Va.); Machar v. Vandewater, 26 Grant, Ch. (U. C.) 83, distinguishing between the disclosure required of one making a sale for himself, and that required of the same person, when he is no longer acting as a vendor, but is engaged to act as agent of a vendee to procure shares from others.

10 Norris v. Taylor, 49 Ill. 17; Arrott v. Brown, 6 Whart. (Pa.) 9.


12 Dry J., in Cave v. Cave, L. R. 15 Ch. D. 639 (1880).


14 Innerarity v. Merchant's Nat. Bank, 137 Mass. 332 (1885), and cases in preceding note. And see In re European Bank, L. R. 5 Ch. 358.
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the principal.” But whatever may be the reason for the exception it stands, with the rule, as undoubtedly law.

It may perhaps be useful to investigate the different reasons given by various authorities in support of the rule. One of these reasons, already outlined and depending upon the duty of the agent to inform his principal of the material facts, is most frequently recognized, not only by writers on agency but by the courts. The other reason, quoted above from the later Massachusetts case, is adopted by one text writer. As pointed out, it has been noticed by the Federal courts. It is discussed at some length by the Georgia court, but not definitely adopted. It should be noted that in every instance in which this reason appears, it is stated as a reason for the exception only; that is, where the agent is engaged in an independent fraud. Suppose the agent is not so engaged, but is acting in the interest of his superior. In such cases, the same authorities agree that the principal is charged with the agent’s knowledge. Is this general rule based upon the affirmative statement of the negative reason given for the exception? This can hardly be so, for it is stated in terms of imputation, thus: “The knowledge of the agent, acting within the scope of his employment, is the knowledge of the principal, for it is presumed that the agent has communicated

Allen v. So. Boston Ry. Co., 150 Mass. 200 (1889). For a possible explanation of this view in Massachusetts, reference may be made to Mussey v. Beecher, 57 Mass. 511 (1849), where it is held that false representations made by an agent not for the benefit of his employer, are not binding upon the latter; i.e., are outside the scope of the employment. The doubt which may exist as to this reason is that though the act in question is clearly within the scope of the agent’s employment, the exception is made. Thus in Bank of Overton v. Thompson, 56 C. C. A. 554 (1902), a bank cashier engaged in business with one Thompson, the plaintiff, and became possessed of a draft as their joint property, and acting wholly alone in the matter, and without the intervention of any other agent or officer of the bank, deposited the same to his own account. Later he withdrew the entire amount of his deposit and embezzled the moneys belonging to the bank. Thompson sought to charge the bank as trustee of his share of the draft, alleging that it had notice of his interest therein. Judgment for Thompson was reversed. The receipt of the deposit of the draft of the cashier was clearly an act within the scope of his authority. But see a perhaps ambiguous statement involving both reasons for the exception, but recognizing that above in Thomson-Houston Elec. Co. v. Cap. Elec. Co., 12 C. C. A. 643, by Taft, Cir. J.

Kennedy v. Green, 3 Myl. & K. 699 (1834); Mechem Agency, sec. 723.

Innerarity v. Merchants’ Nat. Bank, supra; Mechem Agency, sec. 719; Clark & Skyle’s Agency, 1055; Bowstead Agency, 339; 3 Cyc. 595.

Wade on Notice, sec. 690.

such facts to the principal." 16d Thus it appears a presumption must be indulged in, and the reason for the general rule cannot be stated without it. So it follows that wherever a principal is said to have imputed to him the knowledge of his agent, it must be because of circumstances giving rise to a presumption of disclosure. Merely to say that because an agent was acting in the scope of his employment, notice to him is notice to the principal, without any reason why it is so, is to construct a non sequitur. Where the circumstances are such as to give rise to the presumption, it is conclusive to a certain extent; 16e for while the principal cannot be heard to prove it untrue in fact, he may overthrow the basis of the presumption by showing the existence of circumstances which make it more probable that his agent served himself; that is, an opposing interest. But it should be borne in mind that, in the final analysis, there is no difference between the reasons upon which the general rule is said to rest; both depend upon a presumption of disclosure.

Irrespective of the reasons, how are these rules to be applied to the present question? It is certain that the fraudulent agent acts under circumstances which give rise to a presumption that he will not disclose the defect in his title to the money with which he discharges his obligation to the principal. The very purpose of the payment is to conceal his embezzlement. Therefore, the present is a case in which to apply the exception, and the principal should not be charged with notice of facts known to the agent in the transaction. It follows that the principal is without notice of the plaintiff's right in the money and must be classed as a holder for value without notice. The money of the plaintiff having come into his hands, the right of the plaintiff is cut off, and he can no longer either follow it or its product in specie, or recover the amount as a general creditor. 17

But it has recently been suggested 18 that an exception should be engrafted on the exception just indicated, and that the present

16d Story Agency, sec. 140.
18 Newell v. Hadley, 92 N. E. 507 (Mass. 1910), opinion by Mr. Justice Loring; Mr. Chief Justice Knowlton dissenting.
case will fall within that sub-exception, and the result be that the knowledge of the agent is imputable to the principal, and he is therefore liable for the return of the plaintiff's money. The defendant is held to have notice because "the agent and the agent alone acted for the defendant in receiving the attempted payment." The doctrine is announced that an agent's knowledge of his own fraud is to be imputed to the principal in a transaction where the agent alone represents the principal, irrespective of the adverse interest of the agent. Thus it is said, referring to the defendants, "They must be deemed to have known what he knew." Mr. Justice Loring recognizes the main exception by which the knowledge is not imputed, but maintains that the basis of that exception is that the defendant is represented by an innocent person or acts himself in the premises, and lays the entire stress of his argument for the exception to the exception on the fact that the "thief and no one else received for that other the payment so made." The length to which this goes marks its importance. If A is the agent of B, and, being in default to his principal, steals money from C and pays his debt by handing it to B as his (A's) money, B takes a title good against C; whereas if A being intrusted with B's moneys, from which he has purloined the amount to be repaid, places C's money with the other as his payment to B and the squaring of his account, A alone acting in receiving it, B does not have a good title, though the next minute A pays the money to discharge debts which he is authorized and in duty bound to pay from the funds of B in his possession.

It is conceived that this rule of agency is new in so far, at least, as it is expressed in terms of an imputation of the agent's knowledge to the principal. It is further suggested, that though it may be arguable that the elements of this proposition make it in other terms supportable, a question noticed at greater length hereafter, it is not sound as stated, and insufficient to allow the plaintiff to recover.

This new rule has been advanced in several cases; in many rejected absolutely, in others decided against, where if it had been
adopted, contrary results must have been reached, and in a few recognized apparently in words, but as will be argued later, without conscious meaning so to state the rule.

The facts of Bank of Overton v. Thompson have been given in a preceding note. In that case no one acted for the bank save the cashier, who was committing a fraud on the plaintiff under circumstances where, if he disclosed the true character of the transaction to the bank, his plans would have been frustrated. It was held that the knowledge possessed by the agent was not imputable to the principal, though it was the fraud-feasor himself who, as cashier, took the money into the bank. The argument was made that as the cashier alone represented the defendant in the transaction, the former's knowledge should be imputed; but this was expressly denied, since the interest of the agent was such that the presumption was against disclosure.

In National Bank of Nephi v. Foote, a bank cashier procured the signature of the defendant to a note on a condition precedent that it should not be used until a third person had signed as joint maker. Without complying therewith, the cashier, who alone acted in the matter for the bank, discounted the note. In an action by the bank on the note, the defendant claimed the cashier's knowledge of the condition was imputable to the bank, he having solely represented the latter. Merritt, C. J., took occasion to review the authorities and characterized the principle in question as "a distinction which seems to us less substantial than technical and we cannot give it our assent. * * * In a case where the presumption arises that an agent will not communicate his knowledge to his principal, it would seem to be unreasonable to hold the principal responsible for the knowledge of the agent solely because the agent in the particular transaction appeared himself for the principal. The presumption would naturally be, in such case that he would fail to act upon such knowledge as the principal would act, just as he would fail to impart his knowledge where another appeared for the principal."
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In New York the doctrine seems to be followed that where the principal is a corporation, the knowledge of the agent, who alone represents the corporation, is imputable to the latter though his interest was adverse and such that a presumption of non-disclosure would ordinarily arise. Folger, J., said, "Had the principal been an entity, it would have been his duty to have communicated the knowledge in his mind to that principal. Not being an entity, but touching other persons and acting in his own business through him as an agent, his material knowledge became its knowledge." While the possible distinction between a principal in natura persona and an artificial principal is not clearly brought out, the trend of the opinion indicates a thought in the mind of the court that since a corporation can act only through its agents, when the agent with knowledge alone acts in the premises, and no innocent agent is interposed who can be said to represent the corporate principal, it is as if the principal himself were acting had it been the case of a natural person. It should perhaps be noted

20 Holden v. New York & Erie Bank, 72 N. Y. 286 (1878). A trustee who was president and managing officer of the bank, transferred stock of the bank which he knew to be worthless from his own name to himself as trustee, and in payment drew on his trustee account and deposited in his personal account, and subsequently withdrew his entire balance. In an action to set aside the transfer and recover the money drawn from the trust account, it was held that the bank was chargeable with the knowledge possessed by its president in making the transfers.

27 Thompson Corp., sec. 1645 (2nd Ed. 1909). "As corporations, from their nature, can never act except through the instrumentality of their agents * * * this principle applies with peculiar force to them." See also Brobston v. Penniman, 25 S. E. 350 (Ga. 1895). "These cases all proceed upon the idea that as a corporation must of necessity intrust its affairs to officers and agents, and can transact business only through their agency, it must be held chargeable with their acts in the performance of their duty to it; and, if its duly selected servants prove unfaithful to their trust, the corporation itself must suffer rather innocent third persons."

In First National Bank v. Blake, 60 Fed. 78, Cornish held a note as a pledge to be returned upon a certain contingency. He was president and general manager of the plaintiff bank, and as such discounted the note for himself. Held: The knowledge of the condition was imputed to the bank. "If Cornish was the sole representative of the bank in the transaction with himself, there was no one from whom information could have been concealed or to whom it could have been communicated. If he was the sole representative of each party, each must have had equal knowledge. He must necessarily know as much in one capacity as another." While this decision is contra to the prevailing authority in the federal courts, it places the doctrine applied upon the ground that in the case of a corporate principal, there is no one from whom concealment could be made or knowledge given. It is suggested that the whole doctrine of imputed notice in regard to corporate principals, at least so far as it concerns the agency of higher officers, as director, president, or cashier, rests upon different grounds than when applied to principals in
that in the decision nothing is said as to the exception generally recognized when the interest of the agent is adverse to the principal. A few years later the New York Supreme Court held the principal chargeable with the knowledge of the agent where the agent with the knowledge of the fraud alone represented the bank in discounting the note, though his interest was adverse. In this case a distinction is expressly drawn between the facts there and in a case where, though the three fraud-feasors were directors of the bank, none of them was present at any meeting of the board of directors when action was taken in the matter, and in no way acted for the bank in the transactions. In the latter case it was held that under the circumstances, knowledge possessed by the directors engaged in the conspiracy, could not be attributed to the bank. But in the Court of Appeals the exception, that knowledge should not be imputed, was recognized by an undivided court in a case in which the agent alone acted in the matter and in direct opposition to the interests of the principal, a private individual. This decision was followed subsequently in the Supreme Court in regard to a natural person.

The doctrine of the New York cases has not been followed with uniformity. In Iowa it has been denied. In that case the defendant's cashier on his personal account, fraudulently pro-
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eced the plaintiff to make to him his accommodation note, which he negotiated for a draft, and acting wholly alone in the matter, cashed the draft as cashier of the defendant. It was held that the bank was not chargeable with the knowledge of the fraudulent agent. In this case the bank was not seeking to retain the proceeds of the draft, but it was an effort by the plaintiff to follow the draft as proceeds of the note, and therefore dependent upon whether the bank was a holder without notice. In New Jersey the New York cases have not been followed. The president of a defendant bank knew the note in question, payable to and endorsed by him, was based upon an illegal consideration. He discounted it for the bank and the latter was held entitled to recover.

A decision in New Hampshire is distinguishable. The cashier of bank received the defendant's money and gave a receipt therefore in the name of the bank. He did not credit the plaintiff upon the books, but credited his own account, and subsequently withdrew it and absconded. It was contended the bank was not liable on the receipts, the cashier's act having been done in pursuit of an independent, fraudulent scheme for his own benefit, and without the knowledge of the bank, but the liability was imposed. "The bank's promise, not the cashier's fraud, is the foundation of the plaintiff's action. The independent fraud did not affect this promise."

The intermediate court in Missouri has apparently recognized the doctrine in question where the agent with knowledge and in pursuance of a fraudulent scheme of his own, alone represented the bank in making transfers of bank shares on the transfer books, to his own name as trustee. It is perhaps significant that no argument was advanced or notice taken of the rule that where the agent is acting under circumstances which raise the presumption of non-disclosure, his knowledge is not imputable to the principal. In Pennsylvania, the court has affirmed the conclusions of an auditor in which the doctrine of Holden v. New

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*Hanson v. Heard, 38 Atl. 788 (N. H. 1897).*

*Idem, p. 789.*

*Withers v. Lafayette Co. Bank, 67 Mo. App. 115 (1896).*
York, etc., Bank, supra, was adopted. It is submitted that this case is not strong authority to support the proposition dependent upon the fact that the agent with knowledge alone represented the principal. In the first place, the well-recognized exception was left unnoticed by the auditor and court. It was not argued at the bar so far as the briefs disclose. And secondly, the action is one by the bank to enforce the notes received by the act of the agent, a circumstance to be noted hereafter.

The Federal court has been uniform in holding that the knowledge of the agent acting under circumstances rendering it improbable that he would disclose his knowledge, is not to be imputed to the principal, although the latter is a corporation, and the fraudulent agent alone represents it in the transaction. Certain drafts were accepted and delivered to the payee on a condition precedent that he would lend an equal sum to the drawer. In fraud of the acceptor the payee indorsed the same to a corporation of which he was president and credited the drawer's account, he alone acting for the corporation. The latter was held to be a holder for value without notice, and recovered on the paper from the acceptor. An interesting case in the Supreme Court should settle the Federal law on the matter. The adoption of the principle of the sub-exception would have necessitated a different result. The action was brought by a bank receiver against a surety on a cashier's bond. Prior to the execution of the bond, the president and cashier had conspired to rob the bank. The surety company required a certificate from the bank of the cashier's good reputation to accompany the application. This certificate was made by the president alone in representation of the bank and without the knowledge of any director. It was held in an opinion by Mr. Justice Harlan, that the president's knowledge of the cashier's dishonesty could not be imputed to the

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37 Millward-Cliff Cracker Co's Estate, 161 Pa. 151 (1894).
38 Infra, p. 240. And note this same circumstance in Merchants' Nat. Bank v. Tracy, supra; in Holden v. Bank, supra, the deposit by the fraudulent president in his personal account extinguished an overdraft for which the bank sought to retain.
40 American Surety Co. v. Pauly, 170 U. S. 133 (1898).
bank so as to make it responsible as chargeable with the misrepresentations contained in the certificate. After reviewing the cases, it is said, “Further citation of authorities would seem to be unnecessary to support the proposition that if Collins gave the certificate that he might, with the aid of O’Brien as cashier, carry out his purpose to defraud the bank for his personal benefit, the law will not presume that he communicated to the bank what he had done in order to promote the scheme devised by him in hostility to its interests.”

The decision of Mr. Justice Lurton in Niblack v. Cosler is frequently cited in support of the proposition which depends upon the fact that the agent with knowledge alone represented the principal in the transaction, but that case is clearly distinguished, and falls within the general rule that the notice to the agent is imputable to the principal, for from the finding of facts, there was no adverse interest in the agent.

In Georgia the doctrine of the New York cases has been followed. The president and cashier of the bank made a partnership note without authority, to raise their contributions to the firm. Acting alone for the bank they loaned themselves money on the partnership note. In a suit of the bank on the note, it was held that the knowledge of its agents was notice to the bank and neither the partnership nor its other members was liable on the note. In Rhode Island this case is followed upon similar facts. There is a dictum to the same effect in Connecticut.

Before attempting a summary of these cases, the authorities cited by Mr. Justice Loring in the late Massachusetts case should be examined. He takes his authority from two earlier cases in the same state. At the outset it may be pointed out that both rest upon principles of ratification and though, perhaps unfortunately, stated in words of imputation of notice, the language,

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"Idem, p. 159.
80 Fed. 596 (C. C. A. 1897). At p. 599, Mr. Justice Lurton, then Circuit Judge, says, "it is unnecessary to consider the application of this principle to this case, for the reason that the facts do not show that D. was acting for himself or for any firm or corporation in which he had an interest."
"Brobston v. Penniman, supra.
"Cook v. Amer., etc., Co., supra.
"Bank of Milford v. Town of Milford, 36 Conn. 93."
when read in connection with the facts of the cases, leaves this beyond doubt.

The first of these cases is Atlantic Bank v. Merchants' Bank. The defaulting teller of the defendant bank secured by fraud on the plaintiff bank, the sum of money sought to be recovered in the action, in reality, not to make any payment of his debt to the defendant, but merely to cover up his shortage for a day and with intent to return it the next morning. But in one view of the case, acknowledged to be dictum, the court treated it as a payment to the bank of the teller's debt, the money not being returned as intended and the fraud being discovered on the suicide of the teller. Shaw, C. J., held the plaintiff was entitled to recover. It will be noted that here the position of the defendant bank is to hold affirmatively—that which solely by the fraudulent act of its agent, though outside the scope of his authority, has been brought into its possession. In refusing re-payment with knowledge of the circumstances, the defendant ratified that act of the agent, and must therefore ratify the fraud and all. The court, it is true, speaks of notice to the agent as constructive notice to the bank, but the facts of the case show that it is not the notice that is material but the affirmative retention of the benefit thereby secured.

The other case, Atlantic Mills v. Indian Orchard Mills, is similar. The same person was treasurer of both plaintiff and defendant corporations, and was a defaulter to a large amount. To cover his shortage temporarily, he transferred property of one to the credit of the other. It was held not to be a real payment and the money could be recovered. The writer of the opinion then proceeded to deal with the case as if the defaulter had taken the money of the plaintiff, paid it to himself as treasurer of the defendant in discharge of his defalcation, and that this was the payment the defendant sought to retain. Even in this view of the case, it is said recovery must be allowed. Again the court uses language sustaining the rule stated by Mr. Justice

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46 10 Gray, 532 (1858).
47 Idem, p. 552.
48 147 Mass. 268, 17 N. E. 496 (1888).
49 C. Allen, J.
Loring, "Want of knowledge cannot in the view of the law exist, where the party in the transaction is represented solely by one who has knowledge." But the exact meaning of that language is indicated by what immediately follows: "The rule is general, that if one who assumes to do an act which will be for the benefit of another, commits a fraud in so doing, and the person for whose benefit the fraud will enure seeks, after knowledge of the fraud, to avail himself of that act and to retain the benefit of it, he must be held to adopt the whole act, fraud and all and to be charged with the knowledge of it, so far at least as relates to his right to retain the benefit so secured." All that the learned court had in mind was a ratification of the conduct of him who received the money for the defendant by the affirmative retention of it after knowledge. There was no intention to state a definite rule for the imputation of knowledge; and, in the absence of an act of ratification, there would have been no liability on this view of the case. However, the defendant sought to retain that which was in his hands by the receipt of an agent who had notice. By so doing he, though heretofore without knowledge, ratified that receipt and all the knowledge which the receiver had in taking it in discharge of the defalcation. This being the sole principle in the mind of the court, this case and the preceding one, though only dicta in this connection, are undoubtedly correct. If more was meant to be decided, grave doubt must exist as to their soundness. Considering the facts and all that can be gathered from a reading of the entire opinions, any further meaning is improbable.

Having reviewed the available cases bearing on the question where the fraudulent agent alone acts for the principal, they may be briefly summarized. They are, as has been indicated, divisible into three classes. First, the cases in the Federal courts, Utah and Iowa have expressly denied the validity of a doctrine charging the principal with notice because the fraudulent agent alone represented him, provided the interest of the agent is adverse. Second, if the doctrine had been adopted as a principle of imputation of knowledge, contrary results would have been reached in cases noted above, in the Supreme Court of the

*Idem, p. 275.*
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United States, in New York, in Missouri, and in Massachusetts. Third, a class of cases in which the doctrine has been apparently applied and notice charged to the principal. In these cases three things are noticeable. In but few of them was the general exception based upon adversity of interest, presented to the court. In all of them the principal was a corporation, and in all but the last two cases from Massachusetts, a bank. It has been pointed out in a previous note that this may bear upon the question of notice. And finally in every case in which the new rule has been applied, there is clear ratification by the principal, in its very position in the litigation, of the act of the agent who had knowledge of the facts in question. Thus in all the cases of discount, the bank has been seeking to recover on the paper, in its hands solely by the act of the fraudulent agent. That is with knowledge of the fraud, it is seeking to retain the benefit derived therefrom. No clearer case could arise for the application of the doctrine of ratification in solido. In the stock transfer cases the same considerations are present. In the two Massachusetts cases cited by Loring, J., the actual property of the third person was held by the principal. This class of cases seems to have been confined to these three questions.

In Georgia the true basis of the cases apparently applying the new rule, is recognized as the doctrine of ratification. "Where an individual has an interest in a promissory note which he knows was given without consideration, and such individual as cashier of a bank, and without reference to or consultation with any other officer of the bank, discounts said note with the funds of the bank, the latter is not a bona fide purchaser of the note without notice. If it ratifies the act of its officer and claims title to the note, it must take it subject to the knowledge which the officer who discounted it had at the time." A year later this language is quoted with approval and applied in a similar case to hold the bank chargeable with the knowledge of its sole repre-

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33 See note 27, supra.
sentative in discounting a note, though his interest was adverse.\textsuperscript{55} The matter was finally summed up in a later case, when the court said, after reviewing all the prior decisions in that state and many elsewhere, “The decision in each of these cases was based upon the proposition that a corporation which \textit{seeks to enforce for its own benefit} a contract made in its behalf by one of its officers, is in law, chargeable with notice of whatever he knew at the time the contract was entered into.”\textsuperscript{56} In that case, the fraudulent director presented the paper to the cashier who had no knowledge of equities existing between prior parties, and the court distinguishing the case, held that the bank was not charged with the director’s knowledge. The act by which it had possession of the paper was the act of the cashier, and therefore an assertion of rights in the paper was not the affirmative claim of the benefit of the act of a fraud-feasor and so there was no imputation of the knowledge. This view has been expressly adopted and approved in Rhode Island in one of the most recent cases on the subject.\textsuperscript{57} There seems to be no doubt that this is the correct view. No cases have been found in which it has been questioned, but on the contrary wherever the point has been raised, it has been adopted as the reason upon which the rule rests.

If these cases may not be justified on the principle of ratification, or because they invariably raise questions of the representation of a corporation by its higher officers, it might be asked what \textit{a priori} reasons may be given to support the doctrine that where the principal is represented solely by the agent with knowledge, he is charged therewith, but that where there is no such limited representation, he is not to be charged with notice, not actually had, if the interest of the agent is adverse? In the cases affirming this doctrine no reasons are advanced save the general rule, that the knowledge of the agent is the knowledge of the principal. But as has been pointed out, the jurisdictions which acknowledge the doctrine, notably New York, recognize the exception which exists to that general rule, that the knowledge of an agent acting adversely to the interests of

\textsuperscript{55} Fouche v. Merchants’ Nat. Bank, 110 Ga. 827 (1900).
\textsuperscript{57} Cook v. Amer., etc., Co., supra.
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his principal is not to be imputed to the latter. Thus in one case the plaintiff intrusted money to his agent to deposit in the defendant bank, and the agent deposited it in his own name, taking a memorandum check as evidence thereof and representing to the bank it would not be used but returned, after showing to the plaintiff for the purpose of effecting a settlement of partnership accounts between them. The agent fraudulently indorsed the check to the plaintiff, drew the account out on regular checks and absconded. He alone represented the plaintiff in the transaction. In an action on the memorandum check against the bank it was held the knowledge of the agent was not knowledge of the principal, and recovery allowed. Why should the exception be followed in such a case, and not where the case involves the discounting of paper by a bank or similar transaction, and a subsequent suit on the paper by the bank? In each the singleness of representation is equal. In each the interest of the agent bears the same degree of adversity to the principal. As has been pointed out before, the imputation of notice must depend in the final analysis, upon a presumption of disclosure. The conclusive presumption against disclosure is as great in one case as in another. It is submitted therefore, that the cases in effect announcing the doctrine that despite the adversity of interest, the agent's knowledge is charged to the principal where the agent alone represents the principal in the transaction, depend upon entirely different principles from those which deal with the imputation of notice, and are merely examples of the application of the rule of ratification in solid8. Therefore unless the facts of any particular case show ratification on the part of the principal, if the interest of the agent is adverse, his knowledge in the transaction is not chargeable to his principal, even though he alone, acts in the matter.

To again take up the thread of the original investigation, it must now be remembered that by the hypothesis, the money of the plaintiff paid by the fraudulent agent in discharge of

Henry v. Allen, supra.
Hummel v. Bank of Monroe, supra; Bank v. Foote, supra.
his debt to the defendant, has been paid out in turn by the agent in discharge of the debts of the defendant's business. No notice of the plaintiff's rights is imputable to the defendant. It only remains to discover whether the problem can be solved in favor of the plaintiff on the authority of the cases last considered through the principle deduced from them by Mr. Justice Loring has been abandoned. Is there, then, any ratification or adoption by the defendant, of the act of the agent in receiving the payment of the debt to his principal from himself? If so the case should properly be governed by the authorities above.

There is no conduct on the part of the defendant principal which can be said to be on a par with the act of a bank in bringing suit on a note discounted by its cashier for himself, nor of the bank in affirmatively seeking to retain the actual money paid to it by the agent as in the two leading Massachusetts cases. The position of the defendant is very different from asserting an affirmative right when he is defensively protesting an enforced outlay. That his creditors have been satisfied, and will not present claims, is the result of no affirmative act of him, or of any one else adopted by him. That there is no ratification or adoption seems almost self-evident. The authorities on the question of adoption by passive acceptance of the benefit, while not without some difference of expression, uniformly support this view. The conclusion follows that the principal should not be bound by the notice to his agent in such circumstances. He is in the position of a purchaser for value without notice of the plaintiff's rights and as such cannot be held liable on the doctrine of following misappropriated funds. That doctrine having failed, the plaintiff cannot stand as a preferred creditor of the defendant. Whether he can become a general creditor depends on his ability to sustain an action at law or a bill in equity upon some other theory of his case.

Eggleston v. Mason & Co., 84 Iowa, 630 (1862); Henry v. Wilkes, 37 N. Y. 562 (1868); Kelley v. Lindsay, 7 Gray, 287 (1856); Perkins v. Boothby, 71 Me. 91 (1886); Whitwell et al., v. Warner et al., 20 Vt. 425 (1848); Spooner v. Thompson, 48 Vt. 250 (1876). Contra: McDermott v. Jackson, 97 Wis. 64 (1897); Nat. Bank v. Herne, 121 Ill. 25 (1886). The cases denoted contra are in effect dicta only. The recovery given is not based upon the following of misappropriated property, but upon the quasi contractual grounds of a benefit received.
B. TRUSTEE AND CESTUI-QUE TRUST.

In this connection the case is assumed to arise where the fraud-feasor is a trustee and the defendant either his *cestuis que trust* or the trust estate, or both. The ground upon which the recovery is sought must be the same, and depends upon whether notice to a trustee is notice to the trust estate or to the *cestuis que trust*. It is unnecessary to examine in general the subject of the binding force upon the *cestui que trust* of equities of third persons known to the trustee. There can be no doubt that, though under certain circumstances the beneficiary may become bound by knowledge possessed by the fiduciary, he will not be where a principal under similar conditions would not be charged by notice to his agent. Thus if a trustee purchased negotiable paper with trust funds and subsequently the *cestui* ratified the purchase, the equities between prior parties to the paper known to the trustee might become binding upon the *cestui*, though this is doubtful. But where the interest of the trustee is adverse to the beneficiary, his knowledge would be no more imputable than would that of an unfaithful agent. Both the trustee and the agent are fiduciaries in the broad sense, differing only in legal contemplation. An eminent authority on the history and origin of legal relations says originally there was no distinction between agency, trusteeship, or bailment. It is, therefore, submitted that if under similar circumstances, the doctrine of following misappropriated property would not give the plaintiff a right of recovery from a principal, it will not aid him against a trust estate or the *cestuis que trust*.

If these observations upon the subject are sound, it appears that upon the view first adopted of the facts of the hypothetical case, no theory can be advanced upon which a recovery of the

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To establish the ratification of any particular act performed by a trustee, the facts involved must not only be proven, but it must be shown that such ratification was made with full knowledge of all the material particulars and circumstances. St. Paul Trust Co. v. Strong, 88 N. W. 256 (Minn. 1901); Smith v. Howlett, 51 N. Y. S. 910 (1898).

2 Pollock and Maitland's History of English Law, 226-231.

In Newell v. Hadley, Mass. 1910, supra, the rules of imputation of notice were made interchangeable as to the two relationships. Knowlton, C. J., did not adopt this but held that since imputation of notice could not be maintained as to a principal under the circumstances, that was sufficient to dispose of the case between trustee and *cestui que trust*. 
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money or property by the plaintiff can be sustained. To reach such a conclusion is to disagree with the majority of the court in Massachusetts. Respect for that court has made desirable an extended examination of the cases cited for the principle of imputation of notice there adopted, but it is conceived these cases do not support the conclusions drawn from them, and that their real meaning has been indicated above.

II.

A. PRINCIPAL AND AGENT.

In this division of the subject the agent is regarded as having directly paid the debts of his principal’s business with the plaintiff’s money. The sole ground of the liability is the benefit conferred. The plaintiff can hardly be regarded as a volunteer or an officious interloper, and his rights are therefore not barred on that account.66 His money has gone to pay that which otherwise it would have been the defendant’s legal duty to pay.

Some jurisdictions have allowed recovery in such case in an action at law on the common count for money had and received. In others, notably in New England, the right at law is denied. In Illinois, an agent without authority from his principal, guaranteed a note in the latter’s name and thereby procured its discount, and applied the proceeds to the business of the principal. It was held in an action at law, that as to the amount used in his business, the principal was liable pro tanto on the guaranty.67 The decision rests upon principles of quasi-contract or equity in the court of law.68 In Wisconsin, a similar result was reached, though the decision is inextricably confused in language, at least, with principles of ratification.69 In Maine the cases are uniform in allowing a recovery at law to the extent of the benefit conferred upon principles of quasi-contract. Where an agent borrowed money without authority in the name

67 Nat. Bank of Las Vegas v. Obernc, 121 Ill. 25 (1886).
68 Moses v. McFerlan, 2 Barr, 1005.
69 McDermott v. Jackson, 97 Wis. 64 (1897).
of his principal and applied the proceeds to pay the legal obligations of the business, the lender was allowed to recover at law.\textsuperscript{70} In England there is a decision in accord, allowing the action at law;\textsuperscript{71} but a later \textit{dictum} to the contrary.\textsuperscript{72} Massachusetts holds \textit{contra} to these cases through an uniform line of cases.\textsuperscript{73} It is said, “it is not enough to create a liability that the defendant had the benefit of the money by reason of its being expended in his business or in the payment of his debts.”\textsuperscript{74} And although the action in that case was at law, the character of the action is equitable and is always so recognized even in Massachusetts.\textsuperscript{75} In Vermont, the same result is reached.\textsuperscript{76} It is said, “Though money is borrowed by an agent on the credit of a principal without authority, and is used by the agent to pay the debts of the principal’s business which he is managing, the principal is not liable therefore, in the absence of a promise to pay.” The success of an action at law depends therefore, upon the jurisdiction in which it is brought. In those denying recovery at law, redress must be sought by another proceeding, if at all.

A late English decision has allowed the plaintiff to maintain a bill in equity to recover the money or the proceeds of his property, to the extent it has passed to the benefit of the defendant in the payment of the legal obligations of his business.\textsuperscript{77} Romer, L. J., states the equitable rule thus: “Where

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\item \textsuperscript{70} Perkins v. Boothby, 71 Me. 91 (1880); Billings v. Inhabitants of Monmouth, 72 Me. 174 (1881), where the defendant was a municipal corporation.
\item \textsuperscript{71} Reid v. Rigby Co., (1894), 2 Q. B. 40.
\item \textsuperscript{72} Romer, L. J., in Ballantyne v. McIver (1906), 1 K. B. 103, 109.
\item \textsuperscript{74} Dewey, J., in Kelley v. Lindsay, \textit{supra}, at p. 290.
\item \textsuperscript{75} Morton, J., in Claffin v. Godfrey, 21 Pick. 1, 16, speaking of assumpsit for money had and received, “It approaches nearer to a bill in equity than any other common law action: and, indeed, has many of the advantages of a chancery suit.” See Cole v. Bates, 186 Mass. 584, 586. In Hunt v. Amidon, 4 Hill. 345 (N. Y.), Walworth, C., says, “the courts of law, a long time since, fell in love with a part of the jurisdiction of chancery and substituted the equitable remedy of an action of assumpsit upon the common counts for the more dilatory and expensive proceeding of a bill in equity in certain cases.”
\item \textsuperscript{76} Spooner v. Thompson, 48 Vt. 239 (1876).
\item \textsuperscript{77} Bannatyne v. McIver, \textit{supra}.
\end{itemize}
money is borrowed on behalf of a principal by an agent, the lender wrongly believing the agent has authority, then, although the principal cannot be sued at law, yet in equity, to the extent to which the money borrowed has in fact been applied in paying legal debts and obligations of the principal, the lender is entitled to stand in the same position as if the money had originally been borrowed by the principal." It seems there would be no objection to extending this proposition to the case where the money was not borrowed by the agent, but stolen or otherwise unlawfully procured.80

It is well to note at once the limitations put upon this rule. The right is co-extensive only with the application of the plaintiff's money to the payment of debts and obligations, recoverable from the principal. The underlying equity of the doctrine is said to be the same that governs the right in equity of one who lends to a wife, and the cases dealing with ultra vires contracts of corporations. The first class seems to have originated in an English decision in 1718.81 It is there held that one who lends money to a wife to buy necessaries may stand against the husband in equity in the place of him who furnishes the same, though at law the lender of money to a wife would be without remedy.82 This decision has been followed in America.83 A case governed by the same principle is that of a lender to an infant when the money is used to buy necessaries.84

The second class of cases deals with instances of borrowing by corporations as an ultra vires act, the proceeds being used to pay subsisting liabilities of the company.85 Some doubt has existed as to the proper ground upon which these cases should be rested. The earlier cases undoubtedly invoke the doctrine of

81 At p. 109.
82 Newell v. Hadley, supra.
83 Harris v. Lee, 1 P. Wms. 482.
86 Marlow v. Pitfield, 1 P. Wms. 559 (1718).
87 Baroness Wenlock v. River Dee Co., 19 Q. B. D. 155 (1887); In re Cork v. Youghal Ry. Co., L. R. 4 Ch. 748.
An examination of the more recent cases indicates this theory may have been or will be abandoned and a principle of "equity and good conscience" adopted. In an early decision it is said, "The court closes its eyes to the true facts of the case, viz., an advance as a loan by the quasi-lender to the company, and a payment by the company to its creditors as out of its own monies; and assumes on the contrary that the quasi-lender and the creditor of the company met together and that the former advanced to the latter the amount of his claim against the company and took an assignment of that claim for his own benefit." The length to which this fiction has been carried, permitting the recovery of money applied to the payment of debts incurred after the quasi-lending, shows the assignment to be a true fiction. Lord Selborne, C., has marked the limitation of the theory, "The test is, has the transaction really added to the liabilities of the company? If the amount of indebtedness remains in substance unchanged: * * * and nothing is really added to the liability of the company, there has been no real transgression of the principle on which they are prohibited from borrowing." The complete adoption of the fictitious assignment would entitle the so-called assignee to all the securities and priorities of the satisfied creditor. But this has been distinctly denied in England. This of course leads to a repudiation of the remarks of Fry, L. J., and the theory of subrogation. Lindley, M. R., rests the decision upon an equitable limitation of the doctrine of ultra vires. The prohibition against borrowing more than a given sum is, in reality and substance, disobeyed only when an obligation to pay more than that is contracted. The application of the money borrowed shows whether the obligations of the company have been made excessive. Inquiry in this respect is, therefore, made by the courts of equity. The object of the inquiry is to ascertain to what extent the money borrowed from the plaintiff has extinguished other debts of the

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* Fry, L. J., in Baroness Wenlock v. River Dee Co., supra, at p. 165
* Idem.
* In re Wrexham, etc., Ry. (1890), 1 Ch. 440; but see Blackburn Bldg. Soc. v. Cunliffe, 29 Ch. D. 902 (1885).
company, thus preserving the same total indebtedness. This amount is the extent of the plaintiff’s recovery. This is clearly set forth by Giffard, L. J., “inasmuch as his money had gone to pay bills which could be recoverable at law.”91 In the last English case in which the principle has been utilized, an account was directed to ascertain how far claims for which the defendants were held legally liable, had been paid.92

Thus it will be seen, irrespective of the reasons upon which these cases rest, the limitation of the plaintiff’s right is the same. Under neither reasoning can he recover to a greater amount than the total of extinguished legal claims against the defendant.93 This makes it appear that, even in jurisdictions where recovery by the plaintiff would not be permitted at law, a proceeding in equity would be successful. For what reasons this difference between law and equity should be taken, is not made clear. As has been pointed out, Massachusetts recognizes that the action for money had and received is governed by equitable principles, and that this present plaintiff has a sufficient equity in his behalf to maintain a bill, but denies him recovery in assumpsit. It is true the money must be received to maintain the latter, but that has not been the difficulty encountered in Massachusetts. In England the present circumstances are held to constitute a sufficient receipt of the money.94 However, in so far as the proceeds of the agent’s wrong have gone to pay the debts of the defendant, his principal, it would seem the plaintiff may recover, in some jurisdictions at law, in others by bill in equity averring the absence of legal remedy. Though it has been seen that the plaintiff cannot claim as a preferred creditor, in the case of agency, either by a proceeding at law or in equity, he may have a judgment as a general creditor.

92 Bannatyne v. McIver, supra.
94 Reid v. Rigby Co., supra.
B. TRUSTEE AND CEStUI QUE TRUST.

Is the matter changed when the relationship between the fraud-feasor and the defendant ceases to be that of agency, but is a trust? It will be remembered that the trustee is a defaulter to the estate to an equal or larger amount than the sums paid by him to creditors. It is submitted that this circumstance renders considerations applicable to agency beside the mark when applied to a trust. No legal or equitable debts of the defendant cestuis que trust were paid or extinguished when the defaulting trustee used the plaintiff's money to pay the debts incurred by him in executing the trust.

As a trustee, these debts were his legal obligations, and he alone was personally liable therefor. A trustee cannot by contract bind his beneficiary on the trust estate at law. Accordingly if the language of the doctrine applied in the corporation cases is to be taken literally, it is not applicable to the case now under discussion, for no debts were paid with the plaintiff's money which could have been recovered against the trust res or the beneficiaries, at law. Even if the correct interpretation of the principle is to include all claims which might have been recovered from the defendants at law or in equity, this will not change the case where the trustee is a defaulter to the estate. Even in equity, creditors of the trustee cannot charge the trust res or the cestuis que trust for debts incurred in the management of the trust, where the trustee, if he had paid the debts, would not have been entitled to indemnify himself from the trust estate, being a defaulter.

It follows that the plaintiff cannot charge the estate or the beneficiaries. His right depends upon what would have been

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*Owen v. Delamere, 15 Eq. 134 (1872); Noyes v. Blakeman, 6 N. Y. 567 (1852); Poole v. Wilkinson, 42 Ga. 539 (1871).

*15 Amer. Law Rev. 449; Stanton v. King, 15 N. Y. 4 (1876).

*In re Johnson, L. R. 15 Ch. D. 548 (1880); In re Blundell, 44 Ch. D. 1 (1890); Mason v. Pomeroy, 151 Mass. 164 (1890). The right of these creditors of the trustee is to be subrogated to his rights against the estate when he is insolvent. Tennant v. Stoney, 1 Rich. Eq. 222 (1845); Leath v. Ferry, 30 N. J. Eq. 79; Eisenstadt Jewelry Co. v. Mississippi Val. Tr. Co., 72 Mo. App. 514 (1897). An anomalous doctrine prevails in Georgia where the right of the creditor is regarded as an independent equity. Wylly v. Collins & Co., 9 Ga. 223 (1851). And see Louis D. Brandeis, Esq., in 15 Amer. L. Rev. 449. But see also Dr. Wm. Draper Lewis, in 9 Col. Law Rev., at p. 126.
the claim against them, of the creditors who have been paid with his money. This in turn depends upon what would have been the right of the trustee to recoup himself from the trust *res* had he fulfilled his contract with the creditors. In the end the plaintiff's rights depend upon those of the trustee, who is a defaulter. It must be concluded, therefore, that the principles which sustain an action or a bill against a principal in the case of agency, are not sufficient when the instance is one of trust. The state of accounts and the right to indemnity between a disclosed principal and his agent, have no bearing on the rights of creditors, but as between *cestuis que trust* and the trustee, these considerations are of the greatest importance.

To summarize briefly, we find that upon but one theory and in but one class of case, can the plaintiff recover, that is, where his action is against a principal whose debts the fraudulent agent has paid with the money or proceeds of the property wrongfully procured from the plaintiff. In such case he may succeed in an action arising in *quasi-contract* in some jurisdictions; in others only by bill in equity. He becomes a general creditor of the principal but no more. But where the fraudulent person is a trustee, and he is himself in arrears to the trust estate, the plaintiff is without relief upon any theory, save his unprofitable right against the trustee personally. In allowing recovery to the plaintiff in such a case; it is thought the Massachusetts case of Newell v. Hadley, *supra*, is wrong, both as to the erroneous statement of a rule for the imputation of notice, and according to prevailing doctrines, in failing to distinguish between agency and trusteeship in connection with a creditor's right against a principal and the trust *res* or *cestui* respectively.

Ralph J. Baker.