NOTES

THE NATURE OF THE WRITING AND ADMISSIONS OF PARTIES AS AFFECTING APPLICATION OF PAROL EVIDENCE RULE—"It must be kept in mind that the parol evidence rule does not apply every time any written instrument is sought to be affected by testimony of some agreement or understanding not included within it." [1] Indeed it is as important to be familiar with the instances in which the rule has no application as to know the significance and extent of the rule itself; the most difficult part of the parol evidence rule is to determine whether it should be applied to a particular case.

A contracted to do certain painting for B, agreeing to purchase from B the paint required for the job. At the completion of the work A put in a claim of fifteen thousand dollars for extra work. A conference was held at the end of which A wrote a letter to B saying: "I hereby withdraw all claims which I have made for extra work and agree to accept in full settlement thereof the sum of three thousand dollars." Thereafter B sued A for the price of the paints sold by him to A under the contract. At the trial A offered to prove that at the conference which resulted in the compromise, it was understood and agreed that as part of the settlement the amount due for the paints should be cancelled. The trial judge held the testimony incompetent as "an attempt by parol to contradict the writing without evidence of fraud, accident or mistake." [2]

This was reversed by the Supreme Court of Pennsylvania.[3] The writing was a mere letter, "a declaration by defendant as to what he would accept in satisfaction of a particular claim, namely, that for extra work, and it does not pretend to embrace any other transaction between the parties." This seems clearly correct and there would appear to be no justification for the conclusion of the lower court that the important case of *Gianni v. Russell & Co.*[4] made the testimony inadmissible since the opinion there states: "The writing must be the entire contract between the parties if parol evidence is to be excluded and to determine whether it is or not the writing will be looked at and if it appears to be a contract complete within itself 'couched in such terms as import a complete legal obligation without any uncertainty as to the object or extent of the engagement, it is conclusively presumed that the whole engagement of the parties, and the extent and manner of their undertaking, were reduced to writing.' "

Suppose, however, that the writing which will be affected by proffered testimony does appear to be a contract complete within itself but the party offering the testimony has succeeded in making the other

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[1] Garrison v. Salkind, 285 Pa. 265, 132 Atl. 125 (1926).

[2] Reliance was placed entirely on Gianni v. Russell & Co., 281 Pa. 320, 126 Atl. 791 (1924).

[3] Garrison v. Salkind, *supra*, note 1.

[4] *Supra*, note 2. See, also, 74 U. OF PA. L. REV. 235 (1926).

party admit that the writing does not in fact contain the entire agreement. Is it nevertheless "conclusively presumed that the whole engagement of the parties, and the extent and manner of their undertaking, were reduced to writing?" This problem was recently presented.[5] A signed a judgment note which was in the usual form but his defense, upon the trial to determine the validity of the judgment entered thereon, was that the note was given only as security for his payment of such sums as he should receive from the sale of tires consigned to him by B. The plaintiff B, on the other hand, contended that he had sold the tires to A outright, the note represented the purchase price, and that A could not make the attempted defense in view of the absolute and unconditional obligation which he admittedly signed.

After the note was offered in evidence as the plaintiff's case, the defendant immediately called the plaintiff as under cross-examination and succeeded in eliciting from him that the "note wasn't the whole understanding" but that it had been agreed that the defendant should "pay for the tires as they were sold." In view of this testimony, said the Supreme Court, the defense was a proper one. "As plaintiffs admit that the note does not express the entire understanding and agreement between them and defendant, and as the part of their agreement that admittedly was not reduced to writing goes to the very point relied on by defendant for his defense,[6] they cannot invoke the rule that parol evidence cannot be received to vary its terms." This is logical and any other conclusion would have given to the parol evidence rule an undue and unintended importance. "The parol evidence rule exists not for reasons of public policy but to protect those who put their entire contracts in writing."[7] The rule would necessarily be based on public policy or on an irrebuttable legal presumption to sustain the position that, despite the admissions of the parties, evidence of terms of an agreement expressed orally and not included within the writing is inadmissible if the writing on its face is a complete and unambiguous contract.[8]

It is highly important, therefore, before determining that a certain defense to or action upon a written instrument is not permissible under the parol evidence rule (1) to examine the writing (a) to see whether it can properly be called a contract and then (b) to ascertain whether it is couched in such terms as import a complete legal obligation,[9] and (2) to make certain that the party to the written instrument

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[5] Ward v. Zeigler, 285 Pa. 557, 132 Atl. 798 (1926).

[6] This clause represents a very important limitation on the rule that parol evidence is admissible where the parties to the writing admit it does not contain the whole agreement. Such an admission does not open the door altogether.

[7] Schaffer, J. in Ward v. Zeigler, *supra*, note 5.

[8] This position was incorrectly recognized and the decision in Ward v. Zeigler accordingly stamped as "questionable" in a brief comment upon the two cases discussed herein, in 74 U. OF PA. L. REV. 747 (1926).

[9] As more particularly set forth in Gianni v. Russell & Co., *supra*, note 2.

who sets up the parol evidence rule denies the existence of any agreement outside the writing.[10] Under the rule in *Ward v. Zeigler* it would appear to be improper for a court, in cases where there is no averment in the statement of claim or declaration that the writing contains the entire understanding and agreement between the parties thereto, to enter judgment for want of a sufficient affidavit of defense on the ground that the defense set up therein is precluded by the parol evidence rule. Yet this is often done and is still being done although the defendant should be given the opportunity to establish, by cross-examination of the plaintiff, that the contract does not embody the whole agreement but that, in fact, there was an oral agreement made at the same time upon which he relies for his defense.

LIABILITY OF AGENT'S BANK OF DEPOSIT WHERE AGENT HAS DEPOSITED TO HIS INDIVIDUAL ACCOUNT CHECKS DRAWN BY HIM ON PRINCIPAL'S FUNDS—A fiduciary with authority to draw checks on his principal's account, draws such checks to his own order and deposits them to his personal account in his bank. Has the bank any liability in this situation for the misappropriation by the fiduciary of his principal's funds?

In 1913 the United States Circuit Court of Appeals for the Second Circuit laid down the rule in *Havana Central R. R. v. Central Trust Co.*[1] that the depositary bank has a duty to inquire into the propriety of the agent's act. This rule has been repeated and the reasoning of the above case expressly approved and followed by the same court in the case of *Cahan v. Empire Trust Co.*[2] which was decided last January. In that case an agent was authorized to "make, sign, indorse, deposit, draw and deliver" checks drawn on the principal's accounts in two banks. The agent drew twenty-one checks, some payable to himself, the others to the defendant bank in which he had a deposit, and signed them "C. H. Cahan, By C. H. Cahan, Jr., his attorney." They were drawn over a period of two years and all were deposited to the personal account of the agent with the defendant bank, which acted as collecting agent only. All but two of the checks had been certified by the drawee bank before they were deposited. The agent drew checks for his own use on the proceeds of these checks. Upon discovering the facts the principal sued the agent's bank (the depositary of the checks) and recovered.

The sole question considered by the court, and to which it gave an affirmative answer, was: "Is an agent's bank of deposit put on notice by, and does it take at its peril, if it receives without investigation, a

[10] Other instances in which the parol evidence rule has no application will be found briefly adverted to in *Pennsylvania Rule as to Admissibility of Evidence to Establish Contemporaneous Inducing Promises to Affect Written Instruments*, 74 U. OF PA. L. REV. 235 at page 268.

[1] 204 Fed. 546 (C. C. A. 2d, 1913).

[2] 9 Fed. (2d) 713 (C. C. A. 2d, 1926).

check drawn by the agent on his principal's funds to his own order and tendered for the credit of his private account?"

The same question came up in the *Havana Railroad* litigation.[3] The railroad (principal) sued the agent's bank in the New York Court [4] and won, the court being divided 3—2. This decision, however, was reversed in the Court of Appeals.[5] The railroad then brought an action against its depositary bank (the drawee) in the Federal Courts,[6] and again it lost, the court holding that the *form* of the checks did not put the drawee bank on inquiry.[7] The Federal Court in its decision stated that it believed the Court of Appeals was in error in considering the principal's bank its agent to determine whether checks drawn on its account were properly payable or not.[8]

In analyzing the *Cahan* case two factors must be considered: 1. The *notice* conveyed by the form of the checks; 2. The *knowledge* which the defendant bank had when it deposited the checks to the agent's credit. The court said: "This action depends for its success, not on what the drawee banks *did,* but on what the unfaithful agent's bank (the present defendant) *knew.*"

The form of the checks gave the bank notice that they were drawn by an agent on his principal's funds, made payable to the agent, and indorsed by him. The certification gave notice that funds were available to pay the checks and that the agent had authority to draw checks in this form. But it did not give notice that the agent had authority to draw the checks in question. In addition to the notice given by the form of the checks the agent's bank *knew* that the agent was depositing these checks to his personal account. That is all it knew. Is this knowledge, and the notice that the form of the checks gave, sufficient to put it upon inquiry? The Federal Court says yes; apparently the New York Court says no. It is clear that the agent had actual authority to draw checks to his own order; it is equally

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[3] The treasurer of the Havana Railroad drew three checks against the railroad's bank account, payable to the order of himself or X, indorsed them in his own name and deposited them to his personal account in the Knickerbocker Trust Company, which was not the drawee and acted solely as collecting agent.

[4] Havana Central R. R. v. Knickerbocker Trust Co., 135 App. Div. 313, 119 N. Y. Supp. 1035 (1909).

[5] Havana Central R. R. v. Knickerbocker Trust Co., 198 N. Y. 422, 92 N. E. 12 (1910).

[6] Havana Central R. R. v. Central Trust Co., *supra,* note 1.

[7] The Court of Appeals had not decided whether the form of the check, plus the *knowledge* of the agent's bank, put it upon inquiry. It merely assumed, *arguendo,* that even if an inquiry were necessary, presentation of the check to the drawee bank by the depositary bank was a sufficient inquiry, because the drawee bank was the principal's agent to determine whether the checks were properly drawn.

[8] And in Whiting v. Hudson Trust Co., 234 N. Y. 394-404, 138 N. E. 33-37 (1923), Cardozo, *J.,* said: "There may be a technical inaccuracy in describing the drawee bank as the depositor's agent for the purpose of making representations as to the fiduciary's powers.. . . The relation is one, not of agency, but of debtor and creditor."

clear that he did not have authority to draw checks for his own purposes. Did he appear to the defendant to be using the checks for his own purposes? The answer a court gives depends largely on whether it is more impressed with the importance of protecting the principal or of protecting the bank. Consequently, the cases show a marked conflict.

On the general question of when a bank is liable for the misappropriation of funds deposited with it, but not owned by the depositor, three types of cases arise: 1. Where the fiduciary does not have legal title to the funds, as in the principal case; 2. Where he does have legal title, as a trustee; 3. Where any fiduciary uses fiduciary funds to pay his own obligation to his bank. As to the last situation the cases are practically unanimous in holding the bank liable to the real owner of the funds.

In determining the bank's liability the rules of agency must be considered. It is a recognized principle of agency that "whenever the very act of the agent is authorized by the terms of the power, that is, whenever by comparing the act done by the agent with the words of the power, the act is in itself warranted by the terms used, such act is binding on the constituent as to all persons dealing in good faith with the agent. Such persons are not bound to inquire into facts *aliunde*." [9] But it must be remembered that if a person knows, or has knowledge of other facts from which he should know, that the agent is acting for himself, even though the act corresponds with the terms of the authority, such person is not dealing in good faith.[10] However, even though a third person is put on inquiry as to an agent's authority, but fails to inquire, he is in no worse position than he would have been if he had inquired.[11] On the facts of the *Cahan* case it seems that the defendant bank would not have found out the agent was acting wrongfully if it had inquired. The legal situation, to restate it briefly, is that the bank can rely on an act which falls within the terms of the authority unless it knows other facts which prevent it from acting in good faith, and it can only be presumed to know the further facts which an inquiry would have disclosed.

Where the agent is an officer of a corporation the New York Courts have required banks to scrutinize his acts more carefully than the acts of other types of agents. Thus, the New York cases have consistently held that where a third party takes negotiable paper payable to a corporation, and indorsed by an officer of the corporation authorized to do so, and given by him to a third party in payment of his own debt, such action being wrongful, the third party is liable to the corporation.[12] If the officer deposits the check to his own credit,

[9] North River Bank v. Aymar, 3 Hill 262 (N. Y., 1842); Hambro v. Burnand, L. R. 1904, 2 K. B. 10.

[10] Stainer v. Tysen, 3 Hill 279 (N. Y., 1842).

[11] Wilson v. Metropolitan Elev. Rwy., 120 N. Y. 145, 24 N. E. 384 (1890).

[12] Rochester & C. T. R. Co. v. Paviour, 164 N. Y. 281, 58 N. E. 114 (1900); Ward v. City Trust Co., 192 N. Y. 61, 84 N. E. 585 (1908).

or to the credit of a firm in which he is interested, the New York Courts also hold that the bank is put on inquiry.[13] But it does not seem that the bank should be put on inquiry in this latter situation any more than it is in the case where the officer draws a check on the corporation account and deposits it in his personal account. He appears to be dealing with corporation funds as much in the one case as in the other. Yet the courts reach a different decision.[14] Furthermore, it is settled law in New York, and in most other jurisdictions, that an executor can deposit checks, drawn to him as executor, in his personal account without putting the bank on inquiry.[15] New York bases its stricter rule regarding corporation officials on the ground that the corporation can act only through its agents, and must be protected from them. But this is true also of other legal persons, such as estates, and does not appear to be a valid distinction. Other jurisdictions have not tried to distinguish the cases of corporation officers from the other situations and have held, there also, the bank is not put on inquiry by the fact that the officer deposits in his personal account checks payable to the corporation, or drawn by him on its account.[16]

England early held that a bank could safely accept as collateral, on a personal loan of an agent, negotiable paper payable to the principal and indorsed by the agent in the name of the principal.[17] But in

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[13] Wagner Trading Co. v. Battery Park Nat. Bank, 228 N. Y. 37, 126 N. E. 347 (1920); Niagara Woolen Co. v. Pacific Bank, 141 App. Div. 265, 126 N. Y. Supp. 890 (1910).

[14] Havana Central R. R. v. Knickerbocker Trust Co., *supra*, note 5.

[15] Shields v. Bank of Ireland, L. R. 1901, 1 I. R. 222; United States Fidelity & Guaranty Co. v. First Nat. Bank, 18 Calif. App. 437, 123 Pac. 352 (1912); Batchelder v. Central Nat. Bank, 188 Mass. 25, 73 N. E. 1024 (1905); Bischoff v. Yorkville Bank, 218 N. Y. 106, 112 N. E. 759 (1916); Safe Deposit & Trust Co. v. Diamond Nat. Bank, 194 Pa. 334, 44 Atl. 1064 (1900); U. S. Fidelity & Guaranty Co. v. Home Bank, 77 W. Va. 665, 88 S. E. 109 (1916). *Contra:* Duckett v. Mechanics' Bank, 86 Md. 400, 38 Atl. 983 (1897); Bank of Hickory v. McPherson, 102 Miss. 852, 59 So. 934 (1912); United States Fidelity & Guaranty Co. v. People's Bank, 127 Tenn. 720, 157 S. W. 414 (1913).

[16] In McCullam v. Third National Bank, 209 Mo. App. 266, 237 S. W. 1051 (1921), a corporation president drew checks on the corporation account, payable to himself, and deposited them to his personal account. "The mere fact (such) a check . . . is deposited in his individual account . . . does not make the bank liable," said the Court. The facts were practically identical with the *Cahan* case. See also Mott Iron Works v. Metropolitan Bank, 78 Wash. 294, 139 Pac. 36 (1914) (bank held not liable where corporation branch manager deposited to his personal account checks payable to the corporation); Kendall v. Fidelity Trust Co., 230 Mass. 238, 119 N. E. 861 (1918) (checks drawn by assistant treasurer, in his official capacity, payable to his bank and deposited to his personal credit in the bank). In the latter case the agent's bank did not have "any reason to suspect that the depositor was committing a fraud." *Cf.* Park Hotel Company v. Fourth National Bank, 86 Fed. 742 (C. C. A. 8th, 1898) (president drew corporation note payable to himself). But note that a promissory note is a contract, which is not true of a check, and an agent has no right to contract with himself. Also drawing an accommodation note was an *ultra vires* act.

[17] Bank of Bengal v. Fagan, 7 Moo. P. C. 61 (1849).

a Canadian case the bank was held liable for depositing to the personal credit of the secretary of a club, checks payable to the club and indorsed by him.[18] And in the recent case of *Underwood v. Bank of Liverpool*[19] the bank was held liable for conversion on two grounds: 1. The fact the agent deposited his principal's checks in his own account put the bank on inquiry; 2. In so depositing the checks the agent did not appear to be acting for his principal.[20]

The Federal cases do not appear to be in accord with each other. In the Ninth Circuit, the Circuit Court of Appeals has held that a bank is not liable for accepting for deposit to the personal account of the secretary of a corporation, over a period of three years, twenty-one checks payable to the corporation, and indorsed by him as secretary.[21] But in 1925 the Eighth Circuit ruled that a bank is liable for accepting without inquiry warrants payable to a corporation, endorsed by its branch manager, and presented by him for deposit to his private account.[22] In neither of these two cases did the bank have actual knowledge the agent was misappropriating the funds.

If the agent, authorized to draw checks on his principal account, draws a check payable to "cash" and cashes it, instead of depositing it in his personal account, the Federal courts apply a different rule from that of the *Cahan* case. Thus it has been held that a bank may safely cash a check drawn to the order of "cash" on a corporation account, by an officer authorized to draw checks, and presented by him for payment.[23]

This raises an interesting question. Is there really any difference in result between giving an agent the cash over the counter or crediting it to his account? Certainly the principal is equally defrauded in both situations. It is true that where the agent deposits the check, the bank may have more reason to suspect his integrity than where he

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[18] Toronto Club v. Dominion Bank, 25 Ont. L. R. 330 (1911).

[19] L. R. 1924 1 K. B. 775. The sole director of a corporation indorsed checks payable to the corporation and deposited them to his personal credit.

[20] Scrutton, *L. J.*, said: "If banks for fear of offending their customers will not make inquiries into unusual circumstances, they must take with the benefit of not annoying their customer the risk of liability because they do not inquire."

[21] Santa Marina Co. v. Canadian Bank of Commerce, 254 Fed. 391 (C. C. A. 9th, 1918). The Court said the loss was caused by the mistaken confidence the corporation put in its agent and therefore "under the rule of equitable estoppel it cannot recover." Even "gross negligence on the part of the taker at the time of the transfer, will not defeat his title," the Court said. "That result can only be produced by bad faith on his part."

[22] Oklahoma State Bank v. Galion Iron Works, 4 Fed. (2d) 337 (C. C. A. 8th, 1925). Here the Court said the doctrine of equitable estoppel was not applicable.

[23] Warren-Schwarf Asphalt Pav. Co. v. Com. Nat. Bank, 97 Fed. 181 (C. C. A. 6th, 1899). And in Toronto Club v. Dominion Bank, *supra*, note 18, the Court said: "It is one thing to cash a cheque over the counter to an official who has power to indorse and receive the proceeds for his employer, and quite another to receive it and apply it not for the employer's but the official's use."

takes the cash. But the bank's liability, in the words of the court in the *Cahan* case, depends on the affirmative answer to the question, "Did the act of the defendant (bank), in collecting for the personal account of its depositor checks drawn by that depositor as agent of another against his principal's funds, constitute *as matter of law* an assistance to the depositor in an unlawful appropriation of that principal's funds?" In the case of *Warren-Schwarf Asphalt Pav. Co. v. Com. Nat. Bank* [24] it was held that the bank may safely pay the agent, and that such action does not assist the conversion. It would certainly appear that crediting the agent's account with the check does not do anything more to assist him in the conversion. In the *Cahan* case the checks were certified. The unfaithful agent could have cashed them at the drawee bank. This being so, it seems difficult to argue that the act of the agent's bank in collecting the checks was an act which aided the misappropriation, or which made the funds any more available for the agent's personal purposes.

However, as stated above, the rule to be laid down is largely one of business convenience, of public policy. It is apparent that the cases are in considerable conflict, and for a bank to accept fiduciary funds for deposit in a personal account is, at the least, an "unwise and hazardous" practice. It is particularly regrettable that there should be such absolutely conflicting rules between the state and Federal courts in New York, which is the financial center of the country. As matters stand in that state, the bank wins or loses its case on the question of jurisdiction alone. The *Cahan* case has been carried to the Supreme Court of the United States on a writ of *certiorari,* and it is expected argument will be heard in that court some time during the spring of 1927. In the meantime the banking world awaits developments with an unusual amount of interest.

L. H. E.

RELATION BETWEEN OWNER OF PAPER AND SUB-AGENT COLLECTING BANK AFTER COLLECTION—What is the relation between one who deposits paper in a bank for collection and the bank to which such paper is forwarded, when the latter bank accepts a check upon itself as payment? The question has arisen in a recent Federal Circuit Court of Appeals case [1] and it was there decided that the relation was not that of trustee and *cestui que trust,* but a dissenting opinion reached the conclusion that this was the relation that existed. The reasoning of the majority opinion is that, since the check given in payment was one upon the collecting bank there was no augmentation of its assets, but rather a mere shifting of credits on the books; and that, since the funds of the bank were not augmented by collection of the draft in question, there was no reason why equity should fasten

[24] *Supra,* note 23.

[1] Larabee Flour Mills v. First National Bank of Henryetta, 13 F. (2d) 330 (C. C. A. 8th, 1926).

a trust on the general funds in favor of the owner of the paper, thereby giving him a preference over the general creditors of the insolvent bank.

Why the court uses the doctrine of augmentation of assets as the only test to solve the problem is not clear. The doctrine, as shown by the cases cited by the majority opinion,[2] is one used when the problem is that of tracing misappropriated trust funds. This assumes that there is a trust relation and trust funds which could be misappropriated and traced, which is, in the principal case, the very thing to be proved. Until it is first shown that the bank is a trustee no question of tracing can arise. The answer to the question may be that the bank knew that it was insolvent at the time of payment and in taking payment after known insolvency is to be treated as constructive trustee. If this is the situation the case has no bearing upon the ordinary relation of a collecting bank which accepts payment by a check upon itself and the owner of the paper. That this may be the situation is supported by the fact that the draft in question was paid but a very short time before the bank was declared insolvent and also supported by the statement in the opinion, "The collecting banks (two cases are considered together) acted as agents . . . and had they collected and retained the funds called for by the drafts, *as was their duty on account of insolvency* . . ." It seems much more likely, however, that the bank did not know that it was insolvent because (1) The facts of the case do not state that the bank knew it was insolvent. (2) The one case cited which supports the law of this case exactly is not one in which the bank knew it was insolvent.[3] (3) The dissenting judge makes no mention of the bank knowing that it was insolvent and such fact is no part of his reasoning. The answer to the question as to why the court uses the doctrine of augmentation of assets as the sole test to solve the case may be that the court had in mind certain cases in various state courts,[4] mentioned by the dissenting judge, which hold that a check upon the collecting bank augments its assets and it is therefore a trustee for the owner of the paper to the extent of the collection. To this view the court does not wish to subscribe, and in showing why it does not, it neglects to show how the question of tracing arises. Since it seems that the bank did not know of its insolvency, if it really were insolvent at the time of payment, the case will be treated as though the bank did not know that it was insolvent

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[2] Anheuser-Busch Ass'n v. Clayton, 56 Fed. 759 (C. C. A. 5th, 1893); City Bank v. Blackmore, 75 Fed. 771 (C. C. A. 6th, 1896); Beard v. Independent District, 88 Fed. 375 (C. C. A. 8th, 1898); Empire State Surety Co. v. Carroll County, 194 Fed. 593 (C. C. A. 8th, 1912); Mechanics and Metals Nat. Bank v. Buchanan, 12 Fed. (2d) 891 (C. C. A. 8th, 1926).

[3] American Can Co. v. Williams, 178 Fed. 420 (C. C. A. 2d, 1910).

[4] State Nat. Bank v. First Nat. Bank, 124 Ark. 531, 187 S. W. 673 (1916); Goodyear Tire and Rubber Co. v. Hanover State Bank, 109 Kan. 772, 204 Pac. 992 (1921); Hawaiian Pineapple Co. v. Browne, 69 Mont. 140, 220 Pac. 1114 (1923); Bank of Poplar Bluff v. Millspaugh, 281 S. W. 733 (Mo., 1926).

The dissenting judge in reaching his conclusion that the bank should be a trustee argues that a bank can only become a debtor when the owner of the paper consents, in some way, to have it as a debtor rather than a trustee. Such would be the situation when he is a depositor of the bank and gets credit for the collection in his pass book. Thus, according to this view, the bank in the principal case would be a trustee because the owner of the paper was a stranger to the bank and had not in any other way consented to its becoming a debtor. What the trust fund is and how it is to be traced into the general assets of the bank is not pointed out. The judge attempts to dispense with this objection by arguing that in sending its check to the forwarding bank there was a separation of so much money from the general funds as a trust fund. This, of course, is a fiction. The dissenting judge admits that the Federal view upon the question is that there must be an augmentation of assets in order that the bank be a trustee. Assuming that augmentation of assets is the proper test, a very small difference in the facts of a case will work a very material and unwarranted legal result. Thus, if the one who makes payment gives a check on the collecting bank, it is a debtor and the owner of the paper can only recover his *pro rata* share if the bank becomes insolvent; but if the one who makes payment cashes a check at the collecting bank and then deposits the same money as payment, there is an augmentation of the bank's assets and it is a trustee so that if it becomes insolvent the owner of the paper may recover in full. Considering each of these two possible transactions as a whole, there is no real basis for equity aiding the owner of the paper in the latter case and allowing a full recovery, and refusing to aid the owner in the former case.

The state courts, mentioned above, hold, in accord with the view of the dissenting judge in the principal case, that the collecting bank is a trustee unless the owner of the paper consents to its becoming a debtor.[5] These states also have the doctrine that there must be an augmentation of the bank's assets, but, opposed to the Federal courts, they hold that a check on the collecting bank augments its assets. The reasoning is as follows: The collecting bank, if the paper is paid in cash, is a trustee unless, as above, the owner of the paper consents to its becoming a debtor. As a trustee it is obliged to hold these funds separately and if it commingles the trust funds with its general cash, a trust may be fastened upon the general funds to the extent of the misappropriation. When the collecting bank accepts a check upon itself as payment, a duty is imposed upon it to set aside so much money as a trust res. The bank is then presumed to have set aside this money and thus created the trust res. The court having presumed that the money has been set aside, then presumes that it has been commingled with other money of the bank—a breach of trust. This fictitious fund is then traced and a trust fastened upon the general assets of the bank in accordance with the rules of tracing mis-

[5] See cases cited *supra*, note 4.

appropriated trust funds. The only difference between this view and the Federal view, in the absence of consent on the part of the owner of the paper to become a creditor, is concerning the question of augmentation of the bank's assets by an acceptance of a check upon itself, both agreeing that an augmentation of assets is necessary for the bank to become a trustee. In view of the fiction which the state courts employ to support their view and in view of the absurd situation to which the Federal view leads, it is submitted that there is something fundamentally wrong with the use of the doctrine of augmentation of assets as the test to solve the problem presented by the principal case, and that the error is in assuming that the bank is a trustee, and, in accepting a check on itself, or in mixing collected money, commits a breach of trust.

That this phase of the law is very much confused is shown by the fact that there are two other views held by various courts, different from any of the above views, and different from each other. One of them, known as the New York and English view, is that the collecting bank is a sub-agent of the forwarding bank; that the forwarding bank is liable as a debtor to the owner of the paper as soon as the collecting bank receives payment.[6] This makes the forwarding bank a guarantor that the collecting bank will properly perform its duties, and that it will not become insolvent after collection and before remittance. This, it seems, is erroneous in view of the fact that it is the custom of banks to select sub-agents, and the intention of the owner is therefore that such an act shall be within its authority. Under this view it seems that the owner of the paper is in no way concerned with the collecting bank. However, it has been held that he may recover, as a creditor, from the collecting bank if the forwarding bank becomes insolvent before payment to it.[7]

The other view is that the intention of the parties determines the relation when it is doubtful whether that relation, voluntarily entered into, is one of trust or debt.[8] As the relation between the parties in the principal case, and in ones similar to it, is a contract one, it is submitted that the intention of the parties is the proper test as to the nature of that relation. What is the intention of the parties? There is a custom among banks to mix collection money with general funds and to use the money as it sees fit.[9] Payment is then made to the forwarding bank by means of a draft or by mutual credits and a settlement. This custom of banks is so well known that it has been

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[6] Mackersy v. Ramsays Bonars & Co., 9 Cl. & F. 818 (H. L., 1843); St. Nicholas Bank v. State Nat. Bank, 128 N. Y. 26, 27 N. E. 849 (1891).

[7] Naser v. First Nat. Bank, 116 N. Y. 492, 22 N. E. 1077 (1899).

[8] Lippitt v. Thames Loan and Trust Co., 88 Conn. 185, 90 Atl. 369 (1914); Central Trust Co. v. Hanover Trust Co., 242 Mass. 265, 136 N. E. 336 (1922). *Cf.* Commercial Bank v. Armstrong, 148 U. S. 50 (1892).

[9] First Nat. Bank of Richmond v. Wilmington & W. R. Co., 77 Fed. 401 (C. C. A. 4th, 1896); Holder v. Western German Bank, 136 Fed. 90 (C. C. A. 6th, 1905); Lippitt v. Thames Loan and Trust Co., *supra*, note 8; Hawaiian Pineapple Co. v. Browne, *supra*, note 4.

judicially noticed,[10] and shows that the intention of the bank when it undertakes a collection is that it will become a debtor, when the paper is paid, to the party from whom it received it. When one deposits paper for collection and gives no specific instructions, as is usually the situation, he intends that the collection shall be made and the proceeds remitted in the customary manner.[11] Thus, in the absence of specific instructions, the intention of the parties is that the collecting bank shall be a debtor to the forwarding bank. By the form of the indorsement on such paper the collecting bank may have notice of the owner's rights in this debt and so upon the insolvency of the forwarding bank it cannot set off the amount received as payment against debts due it by the forwarding bank.[12] Because of this equity in the debt owed the forwarding bank, the owner may proceed against the collecting bank and recover in full when the forwarding bank becomes insolvent before payment.[13] He, however, can only receive his *pro rata* share as one having an equity in a debt when the collecting bank becomes insolvent after collection and before payment.

The custom of mixing funds became general because the utmost simplicity in the work of collection and remittance was necessary to the proper handling of the enormous amount of such business. This reason, in addition to the intention of the parties, supports the contention that the collecting bank should be held a debtor, rather than a trustee which commits a breach of trust every time, in the usual course of business, it mixes collected funds with general funds. Under this view there is no difference in legal result if the bank accepts a check upon itself rather than cash; no question arises of breach of trust, of tracing misappropriated trust proceeds, or of augmentation of assets; no fictions need be employed, and the customary method of collection and remittance is recognized and sanctioned.

J. H.

ENFORCEMENT OF A LICENSING STATUTE BY INJUNCTION—Although the earliest courts of equity occasionally issued injunctions to restrain the commission of certain crimes, it soon became apparent that the ordinary remedies for the punishment of crime were quite effective.[1] Accordingly, equity refused to become merely an addi-

[10] Lippitt v. Thames Loan and Trust Co., *supra*, note 8.

[11] Freeman's National Bank v. National Tube Works Co., 151 Mass. 413, 24 N. E. 779 (1890).

[12] Evansville Bank v. German American Bank, 155 U. S. 556 (1895); Morris & Co. v. Alabama Carbon Co., 139 Ala. 620, 36 So. 764 (1903); Branch v. United States Nat. Bank, 50 Neb. 470, 70 N. W. 34 (1897); National Citizen's Bank v. Citizen's Nat. Bank, 119 N. C. 307, 25 S. E. 971 (1896).

[13] Branch v. United States Nat. Bank, *supra*, note 12; National Citizen's Bank v. Citizen's Nat. Bank, *supra*, note 12.

[1] 1 POMEROY, EQUITY JURISPRUDENCE (4th ed. 1918), § 36. See Stuart v. LaSalle Co., 83 Ill. 341, 345 (1876).

tional agency for the enforcement of the criminal law and repeatedly refused to enjoin threatened acts solely on the ground that the acts complained of were violations of the criminal law.[2] However, that court has just as consistently held that the criminal nature of the act complained of will not exclude the jurisdiction of equity, where other considerations warrant its intervention.[3] Criminality alone neither gives nor ousts jurisdiction.

In a recent Kentucky case [4] the problem of equity's jurisdiction in connection with a criminal statute was presented in an interesting and exceedingly modern light, when an injunction was granted restraining one from practising dentistry without a license, despite the fact that the statute [5] provided a penalty in the form of a fine for its violation. The court clearly indicated that it did not base its decision upon the right of the commonwealth to abate a nuisance,[6] but declared that the penal provision was merely incidental and was never intended by the legislature to be the sole means of enforcing a statute with the commendable purpose of providing for the public welfare. Substantially the same question has been raised in other jurisdictions, but the decisions are not in accord with that of the Kentucky court. The courts of Illinois,[7] Georgia,[8] and Nebraska [9] have refused to enjoin a chiropractor from practicing without a license in violation of statute, while in Utah [10] under similar circumstances an injunction was issued. In the latter state, however, the use of the equitable remedy as a means of enforcing the statute was expressly authorized in the statute.[11] In the jurisdictions in which the injunction was refused, the courts were unanimous in holding that the practice of chiropractic without a license was neither a public nuisance nor a menace to public health, and they seemed loath to use the injunctive remedy to enforce a statute which provided its own penalty for violation.

The aid of equity has also been sought to enforce other statutes and ordinances in cases closely analogous, the more common being

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[2] *In re* Debs, 158 U. S. 564 (1894); Cope v. District Fair Ass'n, 99 Ill. 489 (1881); Higgins v. Lacroix, 119 Minn. 145, 137 N. W. 417 (1912); Klein v. Livingston Club, 177 Pa. 224, 35 Atl. 606 (1896).

[3] Jones v. Van Winkle Gin and Machine W'ks, 131 Ga. 336, 62 S. E. 236 (1908); Vegelahn v. Guntner, 167 Mass. 92, 44 N. E. 1077 (1896); Cranford v. Tyrrell, 128 N. Y. 341, 28 N. E. 514 (1891); Choctaw Pressed Brick Co. v. Townsend, 108 Okla. 235, 236 Pac. 46 (1925); State v. Ehrlick, 65 W. Va. 700, 64 S. E. 935 (1909).

[4] Kentucky State Board of Dental Examiners v. Payne, 281 S. W. 188 (Ky., 1926).

[5] Ky. Stat., §§ 2636-1 to 2636-22 (Carroll, 1922). Secs. 2636-18 imposes penalty for violation.

[6] 281 S. W. at page 190.

[7] People v. Universal Chiropractors' Ass'n, 302 Ill. 228, 134 N. E. 4 (1922).

[8] Dean v. State, 151 Ga. 371, 106 S. E. 792 (1921).

[9] State v. Maltby, 108 Neb. 578, 188 N. W. 175 (1922).

[10] Board of Medical Examiners v. Blair, 57 Utah 516, 196 Pac. 221 (1921).

[11] Utah Comp. Laws (1917), § 4449.

building and zoning ordinances, and statutes requiring bus operators to obtain a permit or license before operating cars for hire. In the building and zoning ordinance cases, the injunction has generally been refused, the courts repeating, in some cases quite testily, the assertion that criminal statutes will not be enforced by means of an injunction.[12] The courts granting equitable relief in this class of cases either find such violation to be a public nuisance,[13] or discover an injury to some property right to warrant the injunction.[14] The Kentucky court has encountered this problem on two occasions. In *City of Monticello v. Bates*[15] the court admitted the general rule, but held that the punishment for violation was not sufficiently drastic to discourage further violations and the injunction was granted on the ground of inadequacy of remedy.[16] On the second occasion[17] the injunction was refused where the court considered the punishment severe enough to prevent continuous violation.[18] Despite the fact, therefore, that the object of building restrictions and zoning ordinances is to benefit the public at large, in the main the courts refuse to enjoin the violation of these regulations, but rather consider criminal prosecution the natural and proper course in event of a violation.

Nor do the courts feel that the injunction is the proper method to enforce the laws requiring bus operators to obtain permits and licenses,[19] where the violation of the statute is the sole ground suggested for equitable intervention. As it is evident that the general public welfare is intimately connected with statutes of this sort, it is significant that the courts do not consider it necessary to use the injunction to enforce such regulations.

No one will question the propriety of a statute requiring dentists, physicians, chiropractors and persons engaged in certain other professions to be licensed by a state board. The complete reliance upon the

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[12] Incorporated Town of Rochester v. Walters, 27 Ind. App. 194, 60 N. E. 1101 (1901); Village of St. Johns v. McFarlan, 33 Mich. 72 (1875); Mayor of City of Manchester v. Smith, 64 N. H. 380, 10 Atl. 700 (1887); Ventnor City v. Fulmer, 92 N. J. Eq. 478, 113 Atl. 488 (1921); Village of New Rochelle v. Lang, 75 Hun, 608, 27 N. Y. Supp. 600 (1894); Whitridge v. Park, 100 Misc. 367, 165 N. Y. Supp. 640 (Sup. Ct. 1917).

[13] City of New Orleans v. Liberty Shop, 157 La. 26, 101 So. 798 (1924).

[14] Holzbauer v. Ritter, 184 Wis. 35, 198 N. W. 852 (1924).

[15] 163 Ky. 38, 173 S. W. 159 (1915).

[16] The statute set forth no penal provision. In event of a violation, one could be prosecuted under an earlier act and a fine of $100 could be imposed. The fine could be collected but once.

[17] Robinson v. Town of Paintsville, 199 Ky. 247, 250 S. W. 972 (1923), decided by the same Court as decided Kentucky State Board v. Payne, *supra*, note 4.

[18] Under this statute, the defendant could be fined $25 for each day of continued violation.

[19] Healy v. Sidone, 127 Atl. 520 (N. J., 1923); City of San Antonio v. Schutte, 246 S. W. 413 (Tex., 1922). In N. Y., N. H. & H. R. R. v. Deister, 148 N. E. 590 (Mass., 1925), the injunction was granted, but the Court held that the operation of motor busses without a license constituted a nuisance.

skill of such persons on the part of the patient, the increasingly complex treatment administered and the intimate connection of such treatment with public health in general make it imperative that the state by proper regulation protect its citizens from empiricism and incompetency. However, the propriety of the remedy invoked by the Kentucky court to enforce such a statute may well be doubted. For ages people have fought to secure constitutional guarantees of liberty, and government by injunction being regarded as a deprivation of such guarantee, has never been popular. The idea is admirably expressed by St. Paul, J., in his dissenting opinion in a Louisiana [20] case: "Nor do I mean to intimate that to resort to an equity court for an injunction to protect property rights, whether by a government or by a private litigant, can, in any sense, be termed government by injunction. All that is perfectly proper. But . . . if the executive department of the government can, without property interests to protect and merely to 'provide for the general welfare,' substitute an injunction for a penal statute, then we have truly 'government by injunction' in the fullest sense, which if tolerated, would soon dispense with the necessity for a legislative department, and wipe away entirely those constitutional guarantees intended for the protection of individual liberty." The equitable remedy of injunction is an extraordinary remedy, and so it should not be used to enforce a regulation under the police power of a state, but should be confined to cases where property rights are involved, irreparable injury is threatened or the act complained of constitutes a nuisance. No property right is involved in the Kentucky case,[21] nor is irreparable injury threatened. It can hardly be contended that the practice of dentistry without a license constitutes a menace to the public health or welfare, in view of the fact that, upon obtaining a license from the board, the very acts now sought to be restrained would receive legal sanction.[22] Nor can the acts complained of be considered a nuisance, unless the court wishes to adopt literally the definition given in *State v. Crawford,*[23] when Valentine, J., declared: "Every place where a public statute is openly, publicly, repeatedly, continuously, persistently and intentionally violated is a public nuisance." It is apparent, however, that most courts will hesitate to adopt language so broad and comprehensive.[24]

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[20] City of New Orleans v. Liberty Shop, *supra,* note 13.

[21] *Supra,* note 4.

[22] It did not appear that there was anything to prevent the defendant in the Kentucky case from obtaining a license. Hence the act sought to be restrained in that case is not of the same nature as the act in Barrett v. Greenwood Cemetery Ass'n, 159 Ill. 385, 42 N. E. 891 (1896), where the drainage from a cemetery polluted a stream. Such an act is clearly a menace to the public health.

[23] 28 Kan. 726, 733 (1882).

[24] In State v. Lindsay, 85 Kan. 79, 116 Pac. 207 (1911), an injunction was issued restraining defendant from maintaining an asylum for care of persons of unsound mind without first obtaining a license as required by statute. The Court did not consider it necessary to adopt Mr. Justice Valentine's definition of a nuisance, but held that the State could use the injunction to enforce obedience to a statute having such beneficent purpose and effect.

To support its decision, the Kentucky court relies mainly upon the following language used by the court in *In re Debs:* [25] "The obligations which it (the government) is under to promote the interest of all, and to prevent the wrongdoing of one resulting in injury to the general welfare, is often of itself sufficient to give it a standing in court." It will be noted, however, that this language was used in answer to the contention that the government had no interest in the subject-matter as to enable it to appear as party plaintiff in the suit, and cannot reasonably be construed to authorize the unrestricted use of the injunction by any government to enforce provisions for the general welfare, as it appears to have been construed by at least one court.[26] To assert as a ground for equitable interference by injunction that the punishment for violation of the statute is inadequate would be to invade the province of the legislature.[27] The law is provided with machinery for punishing violation of statutes and to it the violation should be referred. If the penalty for violation of a statute seems to be inadequate to effectuate the obvious purpose of the legislature, relief in that direction must come from the law-making power, and not from an extension of equity jurisdiction to a field foreign to its purposes.[28] It would appear that the court in *Kentucky State Board v. Payne,*[29] in its zeal to protect the public from incompetent professional men and women, has sanctioned such an extension. However commendable the purpose, the extension seems to be unwarranted and may bring about a feeling of disfavor towards the court of equity.

J. C. N.

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[25] 158 U. S. 564, 584 (1894).

[26] See State v. Lindsay, 85 Kan. 79, 83, 116 Pac. 207, 208 (1911): "The obligation . . . is often sufficient to give it a standing in court to obtain an injunction." Although *In re* Debs is cited for this proposition, the exact words of the Court are not given.

[27] *Supra,* notes 15 and 16.

[28] State v. Maltby, *supra,* note 9; Sparhawk v. Union Pass. Ry., 54 Pa. 401 (1867), cited with approval in Com. v. Smith, 266 Pa. 511, 109 Atl. 786 (1920).

[29] *Supra,* note 4.