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CONTRACTS — ILLEGALITY — RIGHT OF SURETY OF BANK OFFICER TO RECOVER EMBEZZLED BANK FUNDS LOST IN GAMBLING — *A*, president of *B* bank in South Dakota, embezzled funds which he used in trading in grain futures with *D*, a broker. Neither *A* nor *D* intended any actual delivery of the grain. *P*, surety for *A*, after having paid the bank for *A*'s defalcation, sued *D* to recover the money *A* lost. *Held*, *P* can recover. *Burke Grain Co. v. St. Paul-Mercury Indemnity Co.*, (C. C. A. 8th, 1938) 94 F. (2d) 458.

It would seem clear that at common law the embezzler became a constructive trustee of the embezzled funds,¹ and there is an express statute in South Dakota so providing.² As a general rule, of course, property held in trust or the proceeds thereof may be followed into the hands of holders who are not bona fide purchasers for value without notice.³ Also, in the case of a constructive trust, one may recover against a transferee not a bona fide purchaser,⁴ and circumstances creating a duty to investigate are sufficient to prevent such a transferee from retaining the trust funds.⁵ In the principal case, however, it was not shown that the defendant knew of the origin of the funds, nor could

¹ *Massie v. Watts*, 6 Cranch (10 U. S.) 148 (1810); 65 C. J. 454 (1933); 26 R. C. L. 1232 (1920).

² S. D. Rev. Code (1929), § 1194.

³ *Teal v. Pleasant Grove Local Union*, 200 Ala. 23, 75 So. 335 (1917).

⁴ *Hanby v. First Sav. Bank of Spring Hill*, 197 Iowa 150, 197 N. W. 51 (1924); *Miles v. Coombs*, 120 Me. 453, 115 A. 249 (1921); *Donnelly v. Alden*, 229 Mass. 109, 118 N. E. 298 (1918); *Nesbitt v. Onaway-Alpena Tel. Co.*, 202 Mich. 567, 168 N. W. 519 (1918); *Hughes v. Hughes*, (Tex. Civ. App. 1920) 221 S. W. 970; *Williams v. McCarty*, 82 W. Va. 158, 95 S. E. 638, 100 S. E. 565 (1918); *St. Louis Union Trust Co. v. Harbaugh*, (Tex. Civ. App. 1918) 205 S. W. 496.

⁵ *Pharr v. Fink*, 151 Ark. 305, 237 S. W. 728 (1922); *Keeney v. Bank of Italy*, 33 Cal. App. 515, 165 P. 735 (1917); *In re Seaboard Engineering Co.*, (C. C. A. 4th, 1923) 292 F. 106; *First Nat. Bank v. Sessler*, 54 S. D. 131, 222 N. W. 946 (1928); *Watkins v. Watkins*, 160 Tenn. 1, 22 S. W. (2d) 1 (1930). See also, *Federal Heating Co. v. City of Buffalo*, 182 App. Div. 128, 170 N. Y. S. 515 (1918).

it be charged with such knowledge.⁶ The court held the contracts whereby the broker acquired the funds to be gaming contracts, void as such, and conferring no title on the defendant. While there has been some confusion as to whether similar transactions are illegal,⁷ where neither party intends actually to deliver the commodity, courts have generally held them to be a form of wagering.⁸ Here the transactions were legitimate on their face, but it was apparent that the sole purpose was to wager on the future grain market.⁹ As one court has put it, "It is true that the hand is the hand of Esau, but the voice is the voice of Jacob."¹⁰ At common law, the loser cannot recover gaming losses,¹¹ although numerous statutes abrogate this rule.¹² The reason generally given is that,

⁶ The court said, 94 F. (2d) at 467: "the bank whose money was used by [A] and lost in these transactions was entitled to recover, and this regardless of whether the defendant knew or ought to have known that the funds turned over to it by [A] were those of the bank. . . . The question of the defendant's knowledge of the source of these funds could only have been important if the contracts were otherwise valid ones."

⁷ 83 A. L. R. 522 (1933); 20 A. L. R. 1422 (1922); 49 A. L. R. 1085 (1927).

⁸ *Roundtree v. Smith*, 108 U. S. 269, 2 S. Ct. 630 (1883); *Solomon v. Newburger*, (C. C. A. 8th, 1929) 35 F. (2d) 328; *Barrios & Co. v. G. V. Pettigrew Co.*, 68 Cal. App. 139, 228 P. 676 (1924); *Kennedy v. McCauley*, (Tex. Civ. App. 1923) 248 S. W. 423; *Thompson v. Reiber*, 123 Pa. 457, 16 A. 793 (1889); *Holt v. Wellons*, 163 N. C. 124, 79 S. E. 450 (1913); *Hawke v. Roberts & Hall*, 13 Ohio App. 198 (1920); *Farmers' Elevator Co. v. Quinn-Shepherdson Co.*, 47 S. D. 438, 199 N. W. 201 (1924); *Kendall v. Fries*, 71 N. J. L. 401, 58 A. 1090 (1904); *Donovan v. Daiber*, 124 Mich. 49, 82 N. W. 848 (1900); *Cadwell & Co. v. Lean's Estate*, 169 Mich. 117, 134 N. W. 1110 (1912); *Farnum v. Whitman*, 187 Mass. 381, 73 N. E. 473 (1905); *Wilson v. National Fowling Bank*, 47 Ind. App. 689, 95 N. E. 269 (1911); *Dickson v. Uhlmann Grain Co.*, 288 U. S. 188, 53 S. Ct. 362 (1932). Cf. *Cleage v. Laidley*, (C. C. A. 8th, 1906) 149 F. 346; *Board of Trade of City of Chicago v. Christie Grain & Stock Co.*, 198 U. S. 236, 25 S. Ct. 637 (1905).

⁹ "But, however perfect the likeness of a gambling transaction to the form and features of a legitimate sale, the legality of the dealings between the parties must rest ultimately upon their honest intention. Illegality is seldom guilty of the consummate folly of flaunting its defiance of law in the face of public sentiment—of furnishing itself the evidence of its violation of law. To escape the penalties of breaking the law, it will always put on the 'suits and trappings' of honest transactions. Mere wagering contracts invariably wear the garb of bona fide sales. This is common knowledge." *Dows v. Glaspel*, 4 N. D. 251 at 259-260, 60 N. W. 60 (1894).

¹⁰ *Glasgow v. Nicholls*, 124 Wash. 281 at 285, 214 P. 165 (1923).

¹¹ *Landley v. Fischer*, 226 App. Div. 352, 235 N. Y. S. 368 (1929); *Richter v. Empire Trust Co.*, (D. C. N. Y. 1937) 20 F. Supp. 289; *F. M. Davies & Co. v. Porter*, (C. C. A. 8th, 1918) 248 F. 397; *Grant v. Hamilton*, 3 McLean 100, Fed. Cas. No. 5695 (1842); *Sofas v. McKee*, 100 Conn. 541, 124 A. 380 (1924); *Sutterly v. Fleshman*, 41 Pa. Super. 131 (1909). Contra: *Richardson v. Kelly*, 85 Ill. 491 (1877); *Boner v. Montgomery*, 48 Ky. 123 (1848).

¹² Ark. Dig. Stat. (Pope, 1937), § 6112; Ga. Code (1933), § 20-505; Mass. Gen. Laws (1932), c. 137, § 1; Minn. Stat. (Mason, 1937), § 10217; Tenn. Code (1932), § 7814; Va. Code (1930), § 5559.

although the contract is void, the loser is *in pari delicto*, and will not be helped by the court.¹³ If this be the reason, then logically there would seem to be no reason why a cestui of a trust could not recover from one who had won trust funds from the trustee; the contract by which the winner obtained the funds is void,¹⁴ and the cestui is not barred by being *in pari delicto*.¹⁵ The application of this logic, however, places an extremely severe sanction on the gambler, and this is made particularly clear when it is realized that it is a remedial trust which is being enforced in the principal case—one designed to avoid an unjust enrichment. Even a gambler is entitled to some protection by the law. However, the result of the principal case is clearly supported by authority, both in the case of an express trust¹⁶ and a constructive trust.¹⁷ While a few cases have held otherwise,¹⁸ the majority of courts seem to believe that the public policy against gambling contracts justifies the hardship on the defendant in such a case.¹⁹ Logically, any payment back to the trustee of winnings would seem to be a payment to him personally, rather than as trustee, so that the defendant's liability should be the sum of all moneys paid to him by the trustee, rather than

¹³ *Boon v. Gooch*, 95 Neb. 678, 146 N. W. 930 (1914); *Funk v. Gallivan*, 49 Conn. 124 (1881); *O'Brien v. Luques*, 81 Me. 46, 16 A. 304 (1888); *Northrup v. Buffington*, 171 Mass. 468, 51 N. E. 7 (1898); *Paulk v. Jasper Land Co.*, 116 Ala. 178, 22 So. 495 (1896); *Grant v. Owens*, 55 Ark. 49, 17 S. W. 338 (1891); *Branham v. Stallings*, 21 Colo. 211, 40 P. 396 (1895); *Schlosser v. Smith*, 93 Ind. 83 (1883).

¹⁴ "The illegality of the transaction would taint the title of the buyer, so as to destroy the *bona fides* of the purchase, as fully as actual fraud or want of consideration would do." *Lee v. Boyd*, 86 Ala. 283 at 288, 5 So. 489 (1888).

¹⁵ Principal case, 94 F. (2d) at 467.

¹⁶ *Joslyn v. Downing*, *Hopkins & Co.*, (C. C. A. 9th, 1906) 150 F. 317; *Lee v. Boyd*, 86 Ala. 283, 5 So. 489 (1888); *Pierson v. Fuhrmann*, 1 Colo. App. 187, 27 P. 1015 (1891); *Thompson v. Hynds*, 15 Utah 389, 49 P. 293 (1897).

¹⁷ *Glasgow v. Nicholls*, 124 Wash. 281, 214 P. 165 (1923); *Pearce v. Dill*, 149 Ind. 136, 48 N. E. 788 (1897); *Morrow v. Quinn-Shepherdson Co.*, 48 S. D. 477, 205 N. W. 38 (1925); *Central Stock & Grain Exchange of Chicago v. Bendinger*, (C. C. A. 7th, 1901) 109 F. 926; *Beidler & Robinson Lumber Co. v. Coe Commission Co.*, 13 N. D. 639, 102 N. W. 880 (1905); *Becker v. Fitch*, 66 Okla. 57, 167 P. 202 (1917); *Farmers' Elevator Co. of Westport v. Quinn-Shepherdson Co.*, 47 S. D. 438, 199 N. W. 201 (1924); *Corner v. Pendleton*, 8 Md. 337 (1855); *Pollock v. Agner*, 54 Kan. 618, 38 P. 781 (1895); *Burnham v. Fisher*, 25 Vt. 514 (1853); *Conway v. Conway*, 4 Misc. 312, 24 N. Y. S. 261 (1893); *Smith v. Ray*, 89 Ga. 838, 16 S. E. 90 (1892); *Allen v. Dunham*, 92 Tenn. 257, 21 S. W. 898 (1893); *Ramirez v. Main*, 11 Ariz. 43, 89 P. 508 (1907); *Western Nat. Bank v. State Bank*, 18 Colo. App. 128, 70 P. 439 (1902). Cf. *Oberne, Hasick & Co. v. Bunn*, 39 Ill. App. 122 (1891); *Steamboat Carrie Converse v. Feitig*, 27 La. Ann. 117 (1875).

¹⁸ *Grant v. Owens*, 55 Ark. 49, 17 S. W. 338 (1891); *Thorn & Maginnis v. Wallace*, 113 Miss. 649, 74 So. 610 (1917).

¹⁹ "This conclusion may appear like a hardship to the Central Stock and Grain Exchange, but the hardship is traceable to its violation of law." *Central Stock & Grain Exchange of Chicago v. Bendinger*, (C. C. A. 7th, 1901) 109 F. 926 at 930.

merely the trustee's net losses. Although one case indicates this conclusion,²⁰ such a result, however logical, would seem to impose altogether too great a penalty upon the defendant. The result of the principal case, however, imposes no greater penalty on the defendant than do the many statutes providing for recovery by the loser himself.²¹ The decision, therefore, would appear to be justifiable, although it should be realized that it does impose a rather severe penalty for gambling.

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²⁰ *Central Stock & Grain Exchange of Chicago v. Bendinger*, (C. C. A. 7th, 1901) 109 F. 926.

²¹ *Supra*, note 12.