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PRINCIPAL AND AGENT-WHETHER PRINCIPAL CONSTRUCTIVE TRUSTEE OF MONEY SECURED BY FRAUD FROM THIRD PERSON TO MAKE UP EMBEZZLED FUNDS

Dickson M. Saunders
University of Michigan Law School

PRINCIPAL AND AGENT — WHETHER PRINCIPAL CONSTRUCTIVE TRUSTEE OF MONEY SECURED BY FRAUD FROM THIRD PERSON TO MAKE UP EMBEZZLED FUNDS — Taggart embezzled from his principal, defendant American National Insurance Company, $1,000 received from Miss Mortensen for a deferred life annuity. Subsequently, in a transaction with plaintiff, wholly outside the scope of his general receiving agency for the insurance company, Taggart secured $1,200 through fraud. From this Taggart then replaced the $1,000 due his principal. In suit by plaintiff to recover, Taggart defaulted; liability of the insurance company is based upon the theory that $1,000 has been traced into its hands, and because of Taggart's fraud, this sum became impressed with a constructive trust in favor of the plaintiff. *Held*, insurance company not liable; in accepting the $1,000, which its agent had procured through an independent fraud, as discharge of an antecedent claim, the insurance company is a bona fide purchaser for value, cutting off the constructive trust impressed upon the agent. *Blumberg v. Taggart*, (Minn. 1942) 5 N. W. (2d) 388.

The paramount question in a situation like the instant case is where to fix the limit to the entity the law of agency casts upon those associated as principal and agent.[1] The agent in the principal case stood in the position of a constructive trustee to the defrauded plaintiff,[2] but it does not necessarily follow

[1] HOLMES, COMMON LAW 16-20 (1881), expresses the view that the basis for liability of a principal for his agent's acts is the survival of the earlier liability of the master for the acts of the slave.

[2] RESTITUTION RESTATEMENT, § 166 (1937): "Where the owner of property transfers it, being induced by fraud, duress or undue influence of the transferee, the transferee holds the property upon a constructive trust for the transferor." Accord: Penn Anthracite Mining Co. v. Clarkson Securities Co., 205 Minn. 517, 287 N. W. 15 (1939); Borchert v. Borchert, 132 Wis. 593, 113 N. W. 35 (1907); Ahrens v. Jones, 169 N. Y. 555, 62 N. E. 666 (1902); 3 SCOTT, TRUSTS, § 468 (1939); 26 R. C. L. 1236 (1920); Jennings and Shapiro, "The Minnesota Law of Constructive Trusts and Analogous Equitable Remedies," 25 MINN. L. REV. 667 at 710 (1941).

that his principal is impressed with the same trust. It seems to be a well-established principle that a bona fide purchase for value destroys a constructive trust.[3] Several states have codified the common law as to the cutting off of the rights of a cestui to pursue the property.[4] The defendant insurance company became a bona fide purchaser for value when it entered the credit pursuant to its agent's instructions, for such was in discharge of the antecedent debt owed by the agent to his principal as result of the embezzlement.[5] Absolving the defendant insurance company from restitution is possible through holding that the agent acted outside the scope of his employment.[6] Further, an exception to the rule that the principal is responsible for his agent's acts is established by the line of cases which declares that a principal is not chargeable with the guilty agent's knowledge, when that agent is engaged in a private, independent fraud.[7] The

[3] 3 SCOTT, TRUSTS, § 468 (1939); 2 CONTRACTS RESTATEMENT, § 475 (1932), where the rule is restricted to voidable transfers as distinguished from void transactions between the original parties; 4 BOGERT, TRUSTS AND TRUSTEES, § 881 (1935), ("A most important rule which limits the power of a cestui, or other holder of an equitable interest, to pursue and claim property, is the doctrine which is roughly to the effect that the transfer of the legal estate in property to a bona fide purchaser for value cuts off all equities in the same property."); Ames, "Purchase for Value without Notice," 1 HARV. L. REV. 1 at 3, 16 (1887); Dorr v. Leippe, 286 Pa. 17, 132 A. 806 (1926); United States v. Dunn, 268 U. S. 21, 45 S. Ct. 451 (1925). See also Jennings and Shapiro, "The Minnesota Law of Constructive Trusts and Analagous Equitable Remedies," 25 MINN. L. REV. 667 at 712-713 (1941).

[4] Cal. Civ. Code (Deering, 1941), §§ 856, 2243; Ind. Stat. (Burns, 1933), § 56-602; Kan. Gen. Stat. (1935), § 67-402; Mass. Gen. Laws (1932), c. 203 (real property only); Mich. Comp. Laws (1929), § 12976; N. Y. Consol. Laws (McKinney, 1937), Real Property Law, § 95; Minn. Stat. (Mason, 1927), § 8089.

[5] 4 BOGERT, TRUSTS AND TRUSTEES, § 887 (1935), states that innocently transferred credit in return for trust property is a purchase, a serious change in the financial condition of the taker on the faith of the transfer of the trust property. The Uniform Sales Act, § 76, in force in 33 states, provides, " 'Value' is any consideration sufficient to support a simple contract. An antecedent or pre-existing claim, whether for money or not, constitutes value where goods or documents of title are taken either in satisfaction thereof or as security therefor." See also RESTITUTION RESTATEMENT, § 173 (2) (1937).

[6] The record in the principal case shows the fraud was an independent act, and did not concern the defendant principal at all. 5 N. W. (2d) 388-389. MECHEM, AGENCY, 3d ed., § 554 (1923), states "the principal [will] not be responsible where the agent was not purporting to act for him . . . or where the act complained of was not one, the doing of which can be fairly regarded as a part or incident of the act authorized, and therefore, not within the scope of the authority." See also Stimpson v. Achorn, 158 Mass. 342, 33 N. E. 518 (1893).

[7] American Nat. Bank v. Miller, 229 U. S. 517, 33 S. Ct. 883 (1913); Rudd Lumber Co. v. Anderson, 161 Minn. 353, 201 N.W. 548 (1924) (holding agent not expected to disclose an independent fraud, and perpetrating such fraud is outside scope of his employment); Title Bond & Mtge. Co. v. Carpenter, 240 Mich. 319, 215 N. W. 300 (1927); Cessna v. Hulse, 322 Ill. 589, 153 N. E. 679 (1926); Carlisle v. Norris, 215 N. Y. 400, 109 N. E. 564 (1915); 3 C. J. S. 203, notes 53 and 54, and 204, note 61 (1936); 2 AM. JUR. 292 (1936); 1 AGENCY RESTATEMENT, § 282 (b) (1933).

leading English case in the field, and the precedent around which the American decisions are built, *London & County Banking Co. v. London & Plate Bank*,[8] seems to indicate that the principal may hold the stolen money or negotiable instruments against the world if he does not share the guilty knowledge of the agent. But some cases refuse to follow the reasoning of the English court, and so an exception to the exception has been engrafted, viz., a principal is charged with knowledge of facts known to his agent who is his sole representative in the transaction, even though the agent is himself interested and guilty of wrongdoing.[9] Some courts feel that if a corporation is so lax as to trust the whole of a transaction to one official, it should suffer the consequences.[10] But the principal case seems distinguishable upon the ground that, while the agent acted as representative, sole or otherwise, of the principal in the transaction with Miss Mortensen, he was not in fact a representative of the defendant in the fraudulent dealing with the plaintiff.[11]

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[8] 21 Q. B. D. 535 (1888). In Hummel v. Bank, 75 Iowa 689, 37 N. W. 954 (1888), the bank was ignorant of the fraud of Monroe except through the guilty agent; held, the bank is not charged with notice of the fraud, the usual presumption that an agent has disclosed his knowledge to the principal not arising since the circumstances render it certain that the cashier did not disclose his knowledge to the bank. See also Nassau Bank v. National Bank of Newburgh, 159 N. Y. 456, 54 N. E. 66 (1899).

[9] Brown v. Southwestern Farm Mtge. Co., 112 Kan. 192, 210 P. 658 (1922); Skinner v. Merchant's Bank, 4 Allen (86 Mass.) 290 (1862); Atlantic Cotton Mills v. Indian Orchard Mills, 147 Mass. 268, 17 N. E. 496 (1888) (where *X* was treasurer of both *P* and *D* and stole from *P* to make up for deficits with *D*; held, *D* charged with the agent's knowledge so as to carry on as successor constructive trustee for *P*—because the agent was the sole representative); Curtis, Collins & Holbrook Co. v. United States, 262 U. S. 215, 43 S. Ct. 570 (1923) (perhaps can be distinguished from the principal case in that the fraud occurred in the very thing the corporation was organized to do—secure government lands under stone and timber acts, and court rightly held the corporation charged with the agent's fraud, even though he profited thereby); State Bank of Morton v. Adams, 142 Minn. 63, 170 N. W. 925 (1919); Connecticut Fire Ins. Co. v. Commercial Nat. Bank (C. C. A. 5th, 1937) 87 F. (2d) 968; Holden v. New York & Erie Bank, 72 N. Y. 286 (1878); National Bank of Shamokin v. Waynesboro Knitting Co., 314 Pa. 365, 172 A. 131 (1934); First Nat. Bank v. Dunbar, 118 Ill. 625, 9 N. E. 186 (1886); 2 AM. JUR. 300 (1936); 111 A. L. R. 665 (1937); 48 A. L. R. 464 (1927); 1 AGENCY RESTATEMENT, § 274 (d) (1933).

[10] National Turners Bldg. & Loan Assn. v. Schrietmueller, 288 Mich. 580, 285 N. W. 497 (1939).

[11] The principal case is also noted in 28 IOWA L. REV. 540 (1943).