class and is only cognizable in equity.[20] The problem may be further stripped by an elimination of cases falling within the third classification. Actions calling for purely pecuniary recoveries or the return of chattels without question may be disposed of adequately at law. But in those cases which are to be grouped within the second classification surely, the remedy at law can never be adequate, plain and complete. It is one thing for a court of law to permit the defense of fraud to a suit on a contract or to permit a recovery of damages on account of fraud, and another thing to cancel the obnoxious instrument and place the parties exactly as if the transaction had never taken place, as does a court of equity. In the case of writings, the evidences of the fraudulent act remain *in esse* at law whereas in a suit in equity they are nullified and destroyed. Therefore the adequacy test to which the majority of American courts adhere, although a just and fair rule of thumb, is often a much abused one. It is submitted that the remedy at law is always inadequate where rescission and cancellation are sought and that any limitation upon the jurisdiction of equity in fraud cases, beyond that declared in *Krueger v. Armitage* and the cases applying the doctrine of *Eggers v. Anderson* is a step in the wrong direction.

ARTHUR HANNOCH.

LIABILITY OF BANK FOR MISAPPROPRIATION OF FUNDS BY A FIDUCIARY—DEPOSITOR.—A, a fiduciary, directs a bank to place to his personal credit checks payable to him and signed by him in his fiduciary capacity. Thereafter, A removes the funds and appropriates them to his own use. In a suit against the bank by the person in whose behalf the fiduciary was acting, should the bank be liable as a participant in the fiduciary's breach of obligation? This question, a rather troublesome one to the courts, has called forth a diversity of answers.

The transgressing fiduciary is sometimes an agent acting in behalf of a principal and is sometimes a trustee. Although some cases indicate that the ground for the decision was the distinction between these two classes of fiduciaries, we submit that there is no substantial basis for such distinction in respect to the position of the bank.[1] The agent and the trustee are equally guilty of a breach of duty if they use for their own pecuniary profit the funds of a principal or of a cestui que

[20] Commercial Casualty Co. v. Southern Surety Co., 100 N.J.Eq. 92, *aff'd* 100 N.J.Eq. 738; Schoenfeld v. Winter, 76 N.J.Eq. 511.

[1] See UNIFORM FIDUCIARIES ACT, Sec. 1. The framers of the Act drew no distinction between the types of fiduciaries. Sec. 1 says: "'Fiduciary' includes a trustee under any trust, express, implied, resulting or constructive, executor, administrator, guardian, conservator, curator, receiver, trustee in bankruptcy, assignee for the benefit of creditors, partner, agent, officer of a corporation, public, or private, public officer, or any other person acting in a fiduciary capacity for any other person, trust, or estate."

trust. As to the depository bank, the only question in every case is whether the form of the instrument which is presented to the bank by the fiduciary is such notice of the character of the funds that in crediting the fiduciary's personal account with the funds, the bank becomes liable for any subsequent wrongful diversion by the fiduciary. Whether the check presented to the bank is signed "A, trustee" or "A, agent" is it equally discernible to the bank that the person with whom it is dealing stands in a fiduciary relationship to some other person or thing.

All authorities agree that if the bank has actual knowledge that the fiduciary is using the credit or the funds for his private benefit, the bank becomes responsible for the wrong done and is liable to the extent of the funds it has been instrumental in diverting. It is a firmly settled principle in the law of trusts that one who obtains trust property from a trustee with actual knowledge that the trustee is committing a breach of trust is liable to the cestui que trust. This was the law as to uses in the Fifteenth Century. Thus, where the trustee has in fact no authority to deposit the funds, and the bank actually knows of this lack of authority, the bank will be chargeable with participation in the breach of obligation or be held as constructive trustee of the funds.[2] Likewise, a bank is open to liability where it accepts, in payment of an individual indebtedness, a check payable to a fiduciary and endorsed by him in that capacity, or a check drawn by him upon his account as a fiduciary in that bank or any other bank.[3] Obviously, under such circumstances the bank has knowledge of the fact that the fiduciary is using the funds to his personal advantage. The bank is in the same position where the fiduciary deposits fiduciary funds in his personal account and later pays a debt to the bank by drawing on that account.[4] A New York case, *Bischoff v. Yorkville*

[2] Board of Com'rs. v. Strawn, 157 Fed. 49 (1907) (public officer); State v. Bruce, 17 Ida. 1, 102 Pac. 831 (1909) (public officer); Franklin Sav. Bank v. International Trust Co., 215 Mass. 231, 102 N.E. 363 (1913) (public officer); Quincy Mut. Fire Ins. Co. v. International Trust Co., 217 Mass. 370, 104 N.E. 845 (1914); Tesene v. Iowa State Bank, 173 N.W. 918 (1919) (guardian). Similarly if the bank had no notice that the deposit was wrongful but receives such notice before withdrawal, a subsequent withdrawal will render it liable. Frazier v. Erie Bank, 8 Watts & S. (Pa.) 18 (1844) (agent); Miller v. Bank of Washington, 176 N.C. 152, 96 S.E. 977 (1918) (agent or trustee).

[3] Union Stock Yards v. Gillespie, 137 U.S. 411 (1890) (factor); American Trust & Banking Co. v. Boone, 102 Ga. 202, 29 S.E. 182 (1897) (administrator); Ward v. City Trust Co. of N. Y., 192 N.Y. 61, 84 N.E. 585 (1908) (officer of corporation); Lowndes v. City Nat. Bank, 82 Conn. 8, 72 Atl. 150 (1909) (administrator); Allen v. Puritan Trust Co., 211 Mass. 409, 97 N.E. 916 (1912) (administrator); Bischoff v. Yorkville Bank, 218 N.Y. 106, 112 N.E. 759 (1916) (executor); Hale v. Windsor Sav. Bank, 90 Vt. 487, 98 Atl. 993 (1916) (executor); Brovan v. Kyle, 166 Wis. 347, 165 N.W. 382 (1917) (guardian); Robbins v. Passaic Nat. Bank & Trust Co., 109 N.J.L. 250 (E. & A. 1932) (partner).

[4] Bischoff v. Yorkville Bank, *supra* note 3; Allen v. Puritan Trust Co., *supra* note 3; Robbins v. Passaic Nat. Bank & Trust Co., *supra* note 3; First

Bank, is a good example of this class of cases. In that case E, an executor, deposited money belonging to an estate in the A bank in the name of "E, executor." He had an account, as an individual, in the defendant bank, D. From time to time he drew checks upon the A bank signed by him as executor and payable to the D bank, which checks were sent to the D bank and by his direction placed to his individual credit there. These personal obligations, in the form of notes, were paid as they matured from E's individual account at the bank. The credit was further reduced by other withdrawals by E, some before the payment of the notes and some after, and the proceeds used for purely personal matters. The D bank at no time made any inquiries concerning the funds or the purposes for which they were being used. In a suit against it, the bank was held liable for the amount of the notes and also for all sums withdrawn by E after the payment of the first note, but not for any money withdrawn before payment of the first note. When E applied his individual credit, made up of money of the estate, to his debt at the bank, the bank actually knew that E was using the money for his own benefit. From that point on, the bank no longer had the right to assume that E was using the money in proper performance of his trust. It had every reason to believe that E was probably using the funds as his own. In standing by and making no inquiry or endeavor to prevent the unlawful diversion, the bank, in the eyes of the law, became privy to the misapplication. Although the general rule is that a bank incurs liability when it receives the fruits of the misappropriation by being paid a debt due from the fiduciary, this case goes much farther in holding the bank accountable for everything withdrawn after it received payment on the first note. In a Massachusetts case[6] containing almost identical facts the bank was held chargeable with the amounts received in payment of the fiduciary's debt but incurred no liability as to withdrawals used for other wrongful purposes. Here the liability was confined to the amounts that the bank actually knew were being diverted by the fiduciary.[7]

It is in cases where there was no actual knowledge on the part of the bank that the fiduciary was using or intended to use the fiduciary

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Nat. Bank v. Greene, 114 S.W. (Ky.) 322 (1908) (guardian); U. S. Fidelity & G. Co. v. Union Bank, 228 Fed. (C.C.A. 6) 448 (1913) (public officer).

[5] *Supra* note 3.

[6] Allen v. Puritan Trust Co., *supra* note 3.

[7] See Scott, *Participation in Breach of Trust,* 34 HARV. L. REV. 454, 479. In comparing Bischoff v. Yorkville Bank, and Allen v. Puritan Trust Co., the author submits that the Massachusetts decision is preferable to the New York decision. At p. 479, he says, "To hold that a bank as a creditor must not accept payment from its debtor out of funds which it knows were received by the debtor as a fiduciary without inquiring whether such funds had ceased to be fiduciary funds may be proper. But to hold that a bank as depository is chargeable with notice of all the facts which such inquiry would elicit, would seem to extend the doctrine of constructive notice too far and impose a burdensome responsibility upon the bank."

funds in derogation of his trust that we find a lack of uniformity in the decisions. These cases fall into two general groups, those that hold the bank liable on the theory of constructive notice[8] and those that contend that the bank is exonerated in the absence of actual notice.[9] The decisions that comprise the former group maintain that a bank in placing fiduciary funds to the credit of a fiduciary in his individual capacity, and in subsequently allowing that money to be removed, acts at its peril. Notice of the character of the funds is derived from the face of the instrument presented. If the bank fails to make inquiry as to the propriety of the withdrawals, it must suffer the consequences of its neglect if those withdrawals are in fact improper. The bank is said to have constructive notice of the misapplication and for this reason may be held as a participant in the wrong.

The New Jersey decisions on this subject,[10] with the exception of a very recent case,[11] seem to fall into the group favoring liability of the bank on theories of the law of agency or constructive notice or both. In *Dennis v. Fidelity Union Trust Co.*,[12] checks drawn to the order of a manufacturing company were indorsed by the president of the company and placed to his personal credit in the defendant bank. The bank was held liable to the extent of subsequent defalcations by the president. The court held that the bank was under a duty to inquire as to the authority of the president in crediting his personal account with checks payable to the company. As the bank did nothing to determine the president's authority, it was chargeable with notice of the fact that he lacked such authority. (The treasurer was the only officer with express authority to cash company checks.)[13]

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[8] Dennis Metal Mfg. Co. v. Fidelity Union Trust Co., 99 N.J.L. 365, 123 Atl. 614 (Sup. Ct. 1924); Ward v. City Trust Co. of N. Y., 192 N.Y. 61, 84 N.E. 585 (1908); Cahan v. Empire Trust Co., 271 U.S. 653 (1926); Bischoff v. Yorkville Bank, *supra* note 3.

[9] New Amsterdam &c. Co. v. Nat. Newark &c. Co., 117 N.J.Eq. 264 (1934); Allen v. Puritan Trust Co., *supra* note 3; Allen v. Fourth National Bank, 229 Mass. 239, 112 N.E. 650 (1916); Central Nat. Bank of Baltimore v. Conn. Mut. Life Ins. Co., 104 U.S. 54 (1881); Duckett v. Nat. Mechanics Bank, 86 Md. 400, 38 Atl. 983 (1897); Penn. Title & Trust Co. v. Real Estate Loan & Trust Co., 201 Pa. St. 299, 50 Atl. 998 (1902). A leading English case, Gray v. Johnston, L.R. 3, H. L. 1 (1868), goes far in exonerating a bank. An executrix, having an estate account with her bankers, drew checks against this account, and used the moneys to pay the debts of a firm of which she was a member. Held, there was not such notice to the banker as put him on inquiry and, therefore, he did not participate in her breach of trust. In accord is Shields v. Bank of Ireland, 1 Ir. R. 222 (1901).

[10] American Saw Co. v. First Nat. Bank of Trenton, 60 N.J.L. 417, 38 Atl. 662 (E. & A. 1897); Aerial League of America v. Aircraft Fireproofing Corp., 97 N.J.L. 530, 117 Atl. 704 (E. & A. 1922); Economy Auto Supply Co. v. Fidelity Union Trust Co., 105 N.J.L. 206, 144 Atl. 30 (E. & A. 1928); Robbins v. Passaic Nat. Bank & Trust Co., *supra* note 3; Singer Sewing Machine Co. v. Citizens Nat. Bank & Trust Co., 111 N.J.L. 199 (Sup. Ct. 1933).

[11] New Amsterdam &c. Co. v. Nat. Newark &c. Co., *supra* note 9.

[12] *Supra* note 8.

[13] Similar decisions will be found in American Saw Co. v. First Nat. Bank

In *Robbins v. Passaic Nat. Bank and Trust Co.,*[14] a partner of a stock brokerage firm deposited partnership funds, some in a partnership account, and some in his private account, and later reduced the credit in both accounts by withdrawals for personal purposes. Some of the funds thus removed were used to pay a personal indebtedness to the bank. In a suit by the other partners, the bank was held liable because of the partner-agents' lack of authority to use his principals' funds for his private benefit. The court said that where an agent uses the funds of his principal to pay his own debt to the bank, and there is no implied or actual authority from the principal, the bank is answerable for the misappropriation. It will be noted that although the facts in this case are similar to those in *Bischoff v. Yorkville Bank*[15] and *Allen v. Puritan Trust Co.,*[16] the New Jersey case reasons from the agency angle and does not take into consideration the question of constructive or actual notice as do the New York and Massachusetts cases. Also when the defendant bank urged that the case should be controlled by sections 7 and 9 of the Uniform Fiduciaries Act,[17] which had been adopted by the New Jersey legislature a few years before, the court ruled that on the facts there was no basis upôn which the Act could be invoked. We feel that the Act was applicable; but if it had been applied would not have worked to the advantage of the defendant, but rather would have strengthened the decision in favor of the plaintiff. Section 7 of the Act covers the situation in this case and declares that a bank is not liable unless it was guilty of bad faith or had actual knowledge that the fiduciary was committing a breach of duty. "If, however, such a check is payable to the drawee bank and is delivered to it in payment of or as security for a personal debt of the fiduciary to it, the bank is liable to the principal if the fiduciary in fact commits a breach of his obligation as fiduciary in drawing or delivering the check."[18] As the defendant bank in the Robbins case received some of the checks in payment of the fiduciary's personal debt it is difficult to see why this section of the Act did not govern the situation.

Although some cases seem to have made a distinction where the fiduciary was an agent rather than a trustee, it should not be controlling in those jurisdictions, such as New Jersey, that have adopted the Fiduciaries' Act. Section 1 of the Act declares that the word fiduciary as used in the Act includes a trustee, executor, receiver, partner, agent,

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of Trenton, *supra* note 10; Aerial League of America v. Aircraft Fireproofing Corp., *supra* note 10; Economy Auto Supply Co. v. Fidelity Union Trust Co., *supra* note 10.

[14] *Supra* note 3.

[15] *Supra* note 3.

[16] *Supra* note 3.

[17] UNIFORM FIDUCIARIES ACT, Sec. 7, 9. The act was adopted by the New Jersey legislature in 1927. P.L. 1927, Ch. 30.

[18] UNIFORM FIDUCIARIES ACT, Sec. 7.

officer of a corporation, etc.[19]

Although the Uniform Fiduciaries' Act was made the law in the State of New Jersey in 1927,[20] the recent case of *New Amsterdam &c. Co. v. Nat. Newark &c. Co.*[21] is the first to be decided directly under the Act. In this case A was the receiver of an insolvent corporation. He deposited receivership funds to the credit of "A, receiver" in several different banks. Upon these accounts he later drew checks to his own order or to cash and embezzled the proceeds. It was sought to hold the banks as participants in the breach of trust. The plaintiff contended that the checks by which the diversion was accomplished were such on their faces that the banks were under a duty to inquire as to the propriety of A's withdrawals, and that the banks were charged with notice of the fact that A was using the fiduciary funds wrongfully. The court held that the banks were not liable; that the standard of due care and the doctrine of constructive notice, which the plaintiff sought to invoke, were in nowise controlling as they find no recognition in the Fiduciaries' Act. As the banks were not guilty of bad faith and had no actual knowledge that the fiduciary was diverting the funds to his own use, they were immune. The court points out that the relationship of a bank to a trustee-depositor is that debtor and creditor and that the bank's obligation is to honor the checks of the trustee when drawn in the proper form. As there is no privity between the bank and the cestui que trust, the only duty owing from the bank to the cestui or trust estate is to refrain from participating in any misappropriation of funds. The mere payment of money to the fiduciary-depositor does not constitute participation in the misappropriation, nor is there any duty upon the bank to inquire into the conduct of such fiduciary-depositor.[22]

In general, the purpose of the Uniform Fiduciaries' Act was to clarify and codify the law in respect to fiduciaries and situations in which fiduciaries were involved.[23] In view of the numerous conflicting decisions on the subject a great need had arisen for realignment and for an authoritative standard by which the courts might be guided to uniformity. The particular purpose behind sections 7 and 9 of the Act was to relieve banks of the tremendous burden that was being placed upon them by those jurisdictions imposing liability for peculations of fiduciary-depositors on constructive notice alone. A bank, held to act at its peril in dealing with fiduciary funds, must take its choice between supervising each deposit or refusing banking privileges to fiduciaries. In view of the complication of the modern banking business, acting as a virtual detective is practically impossible.

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[19] For exact words of Sec. 1 of the Act see *supra* note 1.

[20] P.L. 1927, Ch. 30.

[21] *Supra* note 9.

[22] See PERRY, TRUSTS (7th Ed.), p. 177 for a discussion of these principles.

[23] See 9 U. L. A. 147, wherein the Commissioners explain the purpose of the Fiduciaries Act.

The alternative of refusing to accept the fiduciary type of deposit would work to the great disadvantage of principals, cestuis, estates, and fiduciaries generally. Thus, the Act, by exonerating the bank except when it is guilty of bad faith or actual knowledge[24] of the fiduciary's actual or intended misappropriation, removes the oppressive and unreasonable burden heretofore imposed by some of our courts.

The case of *New Amsterdam &c. Co. v. Nat. Newark &c.* Co.,[25] in expressly discarding the artificial and discriminatory standards of due care and constructive notice and in adopting without reservation the standards of the Fiduciaries Act, has done much in clearing up the ambiguous situation in New Jersey. It is hoped that in the future the provisions of the Act will be applied with equal force, irrespective of whether the fiduciary is a trustee type or an agent type, as such is the intent of the Act.

MORTGAGE DEFICIENCIES DURING THE ECONOMIC EMERGENCY.—The purpose of this note is to bring down to date the recent article on "Mortgage Deficiencies in New Jersey".[1]

The case of *Federal Title & Mortgage Co. v. Lowenstein*[2] laid down the rule that equity may compel a mortgagee to credit the fair market value of the mortgaged premises on the decree in a suit on a deficiency after foreclosure. In order to qualify for the relief granted in the above case the mortgagor must show, first, that the property was knocked down at the sale at an unconscionable figure, second, the existence of an economic emergency which prevented competitive bidding, and third, his own inability to protect himself by refinancing or by bidding at the sale.[3] The necessity for financal irresponsibility on the part of the mortgagor was set out fully in *Maher v. Usbe B. & L. Ass'n.*[4] In that case the court declared that a wealthy mortgagor may not take advantage of the Lowenstein doctrine to unload unwanted property on

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[24] There should be little doubt as to what the act means by the words "actual knowledge." A want of diligence to ascertain inculpatory facts is not actual knowledge of such facts. However, the meaning of "bad faith" is rather troublesome. Although the Act does not define "bad faith" it defines "good faith" in respect to a thing done "when it is in fact done honestly." It should follow that a thing done in "bad faith" is one done dishonestly. In Browning v. Fidelity Trust Co., 250 Fed. 321 (1918) the court says: "bad faith * * * differs from the negative idea of negligence in that it contemplates a state of mind affirmatively operating with a furtive design or some motive of interest or ill will. It contains an element of intent to do wrong in some degree, actually or necessarily inferable."

[25] *Supra* note 9.

[1] Eisenberg & Spicer, MERCER BEASLEY LAW REVIEW, Jan. 1933, p. 27.

[2] 113 N. J. Eq. 200 (Ch. 1933).

[3] Young v. Weber, 117 N. J. Eq. 242 (Ch. 1934).

[4] 116 N. J. Eq. 399 (Ch. 1934).