

## LIABILITY OF PRINCIPAL FOR FRAUD OF AGENT, COMMITTED FOR AGENT'S BENEFIT.

The question of the liability of the principal for fraud committed by the agent within the apparent scope of his authority, and under cover of the principal's name and business, but for the agent's benefit, is one that is by no means settled. There is a sharp conflict of authority on this question and two well-defined and directly conflicting lines of decisions have been followed in the courts of the several States. One group of State Courts and the United States Supreme Court have followed what is commonly referred to as the English rule, while another group has followed the so-called New York rule.

The question most frequently arises in cases involving the issue of fictitious bills of lading, and the fraudulent issue of certificates of corporation stocks; but has also been presented for adjudication in widely varying types of cases, such as, misrepresentation to a subscriber of a mercantile agency as to the financial standing of a merchant; the fraudulent certifying of a bank check by the bank's cashier; fraudulent sale of property by an agent of a real estate firm for his own benefit, and many others. The legal question involved in all of these cases, however, seems to be the same: e. g., the liability of the personally innocent principal when the fraud was not perpetrated for his benefit.

In England the decisions seem to have been uniformly to the effect that a principal is never liable under such circumstances until the comparatively recent case of *Lloyd v. Grace, Smith & Co.*,<sup>1</sup> which apparently overrules the view referred to by our courts as the English rule. This case is authority for the proposition that "A principal is liable for the fraud of his agent acting within the scope of his authority, whether the fraud is committed for the benefit of the principal or for the benefit of the agent."

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1. (1912) Appeal Cases, 716.

Among the English cases most frequently cited as authority for the proposition that the principal is not liable, is that of *Grant v. Norway*.<sup>2</sup> This case decided that the owner of a ship was not liable in an action upon the case by the endorsees of a bill of lading issued by the ship's master for goods which had never been shipped. The decision was based upon the ground that the master was not to be considered as the agent of the owner in that behalf. Jervis, C. J., in delivering the judgment of the Court said, in part:

“The master is the general agent to perform all things relating to the usual employment of his ship; and the authority of such an agent to perform all things usual in the line of business in which he is employed, cannot be limited by any private order or direction not known to the party dealing with him. It is not contended that the captain had any real authority to sign bills of lading, unless the goods had been shipped; nor can we discover any ground upon which a party taking a bill of lading by endorsement, would be justified in assuming that he had authority to sign such bills, whether the goods were on board or not.”

Professor Huffcutt in his text on Agency<sup>3</sup> says of the cases of this class: “It is held that the principal is not liable, the argument being that the agent is authorized to do what is usual in his agency and it is not usual to issue fictitious bills of lading. This play upon words, if restorted to in other cases, would excuse the constituent for every tort of his representative.” The rule laid down in the above case has been followed, however, and the case cited as authority for the rule, by the U. S. Supreme Court in *Friedlander v. Texas etc. Ry.*<sup>4</sup>

In Minnesota, in the case of *National Bank of Commerce v. C. B. & N. R. R. Co.*,<sup>5</sup> the principal case is cited and relied

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2. Common Bench, 665.

3. Huffcutt on Agency, Sec. 156.

4. 130 U. S. 416.

5. 44 Minn. 224.

on for the proposition that "even as against a bona fide consignee or endorsee for value, the carrier is not estopped by the statements of the bill of lading, issued by his agent, from showing that no goods were in fact received for transportation." In the later case of *Swedish Am. Bank v. C. B. & Q. R. R.*,<sup>6</sup> the rule in *Grant v. Norway* is again followed, the earlier case of *McCord v. Western Union Telegraph Co.*<sup>7</sup> apparently being overruled by these cases.

In *National Bank v. Ry.* (*supra*) the Court said in commenting on *McCord v. Western Union Tel. Co.*: "The reasoning of these cases is in substance that the question does not at all depend upon the negotiability of bills of lading, but upon the principle of estoppel in pais; that where a principal has clothed an agent with power to do an act in case of the existence of some extrinsic fact, necessarily and peculiarly within the knowledge of the agent, and of the existence of which the act of executing the power is itself a representation, the principal is estopped from denying the existence of the fact, to the prejudice of a third person who has dealt with the agent or acted upon his representation in good faith, in the ordinary course of business. This rule this Court in effect adopted and applied in *McCord v. Western Union Tel. Co.* It is urged that force is added to this reasoning in view of the fact that bills of lading are viewed and dealt with in the commercial world as quasi negotiable, and consequently it is desirable that they should be viewed with confidence and not distrust; and that for these considerations it is better to cast the risk of the goods not having been shipped upon the carrier, who has placed it in the power of agents of his own choosing to make these representations, rather than upon the innocent consignee or indorsee, who, as a rule, has no means of ascertaining the fact.

"If the question *was res integra*, we confess that it seems to us that this argument would be very cogent. But, on the other

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6. 96 Minn. 436.

7. 39 Minn. 181.

hand, it may be said that carriers are not in the business of issuing and dealing in bills of lading in the same sense in which bankers issue and deal in bills of exchange; that their business is transporting property; and that if the statements in the receipt part of bills of lading are to be held conclusive upon them, although false, it would open so wide a door for fraud and collusion that the disastrous consequences to the carriers would far outweigh the inconvenience resulting to the commercial world from the opposite rule. It is also to be admitted that it requires some temerity to attack either the policy or the soundness of the rule which seems to have stood the test of experience, which has been approved by so many eminent courts, and under which the most successful commercial nation in the world has developed and conducted her vast commerce ever since the inception of carriers' bills of lading. But, on questions of commercial law, it is eminently desirable that there be uniformity. It is even more important that the rule be uniform and certain than that it be the best one that might be adopted. Moreover, on questions of general commercial law the Federal courts refuse to follow the decisions of the State courts, and determine the law according to their own views of what it is. It is therefore very desirable that on such questions the State courts should conform to the doctrine of the Federal courts. The inconvenience and confusion that would follow from having two conflicting rules on the same question in the same State, one in the Federal courts and another in the State courts, is of itself almost a sufficient reason why we should adopt the doctrine of the Federal courts on this question."

The rule enunciated in *Grant v. Norway* has been followed and the case cited by the courts of, among others, Washington

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8. 42 Wash. 572. (Compare with 67 Wash. 286.)

9. 22 Ohio St. 118. (Compare with 56 Ohio St. 351, in which the opposite view seems to prevail.)

in *Roy & Roy v. Northern Pac. R. R. Co.*;<sup>8</sup> Ohio in *Dean v. King*,<sup>9</sup> and Missouri in *La. National Bank v. Laveille*.<sup>10</sup>

The courts of New York, however, refused to adopt the rule laid down in *Grant v. Norway* and in *Armour v. Mich. Central R. R. Co.*,<sup>11</sup> held that the carrier was liable for non-delivery of goods represented by bills of lading issued by his agent on the faith of what subsequently proved to be forged warehouse receipts. Although the facts are somewhat different from that of *Grant v. Norway*, inasmuch as the agent of the railroad company had acted in good faith, the Court, per Dwight, C., said in part: "Grant v. Norway has been subject to much and severe criticism, as being adverse to the general view prevailing in the courts of this State, where confidence has been reposed in an agent and an apparent authority conferred upon him, that the principal must suffer from an actual exercise of authority not exceeding the appearance of that which is granted. When one of two innocent persons must suffer in such a case, that person must bear the loss who reposed the confidence. So far as *Grant v. Norway* stands in the way of this doctrine, it must be deemed to be overruled."

This case has been followed by subsequent cases in the same and other jurisdictions. In *Bank of Batavia v. N. Y. L. E. & W. R. R. Co.*,<sup>12</sup> the question arose through the issuance of a bill of lading, for which no goods were received, in pursuance of a conspiracy between defendants' agent and a third person. The Court held that the doctrine of estoppel in pais applied and, following *Armour v. Mich. Cent. R. R.*, allowed the plaintiff to recover.

This rule seems to be firmly established in New York and

10. 52 Missouri 380. (Compare with 259 Mo. 637, commented on in this note.)

11. 65 N. Y. 111.

12. 106 N. Y. 195.

13. 108 Pa. St. 529.

14. 103 Ill. 293.

15. 20 Kas. 519.

16. 10 Neb. 556.

has been followed in Pennsylvania;<sup>13</sup> Illinois;<sup>14</sup> Kansas;<sup>15</sup> Nebraska,<sup>16</sup> and South Dakota.<sup>17</sup>

Thus, it will be seen, the group of State courts which follow the New York rule is in irreconcilable conflict with the courts which follow the rule laid down in *Grant v. Norway* and approved by the United States Supreme Court, at least in cases involving the issue of fictitious bills of lading and warehouse receipts.

The other principal class of cases in which the question under consideration is presented, that of cases involving the fraudulent issue of stock certificates, seems to be as conflicting.

What, until *Lloyd v. Grace, Smith & Co.* (1912) (*supra*), had been the rule followed in these cases in England, seems to have been largely based on an opinion delivered by Mr. Justice Willes in *Barwick v. English Joint Stock Bank*.<sup>18</sup> The facts of this case were as follows: The plaintiff having for some time, on a guarantee of the defendants, supplied J. D., a customer of theirs, with oats on credit, for carrying out a government contract, refused to continue to do so unless he had a better guarantee. The defendants' manager thereupon gave him a written guarantee to the effect that the customer's check on the bank in the plaintiff's favor, in payment for the oats supplied, should be paid, on receipt of the government money, in priority to any other payment, "except to this bank." J. D. was then indebted to the bank to the amount of 12,000 pounds, but this fact was not known to the plaintiff, nor was it communicated to him by the manager. The plaintiff thereupon supplied the oats to the value of 1227 pounds; the government money, amounting to 2676 pounds, was received by J. D., and paid into the bank; but J. D.'s check for the price of oats drawn on the bank in favor of the plaintiff was dishonored by the defendants, who claimed to retain the whole sum of 2676 pounds, in payment of J. D.'s debt to them.

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17. 12 So. Dak. 643.

18. L. R. 2 Ex. 259.

The plaintiff brought an action for false representation and for money had and received. The trial court, on the evidence given for the plaintiff, ruled there was no evidence to go to the jury in support of the plaintiff's case, and accordingly directed a non-suit, but signed a bill of exception setting out the evidence. On review the judgment of the Court of Exchequer was delivered by Mr. Justice Willes and held:

First. That there was evidence to go to the jury that the manager knew and intended that the guarantee should be un-availing, and fraudulently concealed from the plaintiff the fact which would make it so.

Secondly. That the defendants would be liable for such fraud in their agent.

Thirdly. That the fraud was properly charged in the declaration as the fraud of the defendants.

It is apparent, after scrutinizing the facts, that the question under consideration in this note, namely, fraud for the agent's benefit, was not involved in this case. Here the fraud perpetrated by the manager was clearly for the benefit, not of the manager, but of the bank. In the course of his opinion, however, Mr. Justice Willes gave utterance to the statement that the general rule, which has been followed by the subsequent English cases involving the question under consideration, until the case of *Lloyd v. Grace, Smith & Co.* (1912) (*supra*), is "that the master is answerable for every such wrong of the servant or agent as is committed in the course of the service *and for the master's benefit*,<sup>19</sup> though no express command or privity of the master be proved."

The first important case in which the ruling in Barwick's case was discussed was that of *Mackay v. Commercial Bank of*

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19. The italics are the writer's.

*New Brunswick*,<sup>20</sup> decided in 1874. In that case the ruling of Mr. Justice Willes was reaffirmed. There the fraud was again for the benefit of the principal. Sir Montague Smith, in delivering the judgment of the court, observed that it was regarded as "settled law that a principal is answerable where he has received a benefit from the fraud of his agent, acting within the scope of his authority."

The case which probably is most frequently cited by American courts and text book writers as being an authority for the English rule, that of the *British Mutual Banking Co. v. The Charmwood Forest Railway Company*,<sup>21</sup> was decided in the Court of Appeals in 1887. The facts presented were substantially these: The secretary of a company answered questions which were put to him as secretary as to the validity of certain debenture stock of the company. The answers were untrue and were fraudulently made by the secretary for his own benefit. In an action against the company for loss arising from the representations, the jury found that the secretary was held out by the company as a person to answer such inquiries on their behalf. In delivering the judgment of the court, that the company was not liable, Lord Justice Bowen said in part:

"The true rule, as it seems to me, was enunciated by the Exchequer Chamber in a judgment of Willes, J., delivered in the case of *Barwick v. English Joint Stock Bank*. 'The general rule,' says Willes, J., 'is that the master is answerable for every such wrong of his servant or agent as is committed in the course of his service and for his master's benefit, though no express command or privity of the master be proved.' "

Again, in *Ruben v. Great Fingall Consolidated*,<sup>22</sup> decided in the House of Lords in 1906, we find the rule laid down by

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20. L. R. 5 P. C. 394.

21. L. R. 18 Q. B. Div. 714.

22. (1906) A. C. at page 145.



Mr. Justice Willes quoted by Lord Davey, as authority for the proposition that "Where the secretary is acting fraudulently for his own illegal purposes, no representation by him relating to the matter will bind his employer." However, the exact question under consideration in this note was not involved, inasmuch as there was no evidence that the company had ever held out the secretary as having authority to do anything more than the mere ministerial act of delivering share certificates, when duly made, to the owners of the shares. The secretary had forged the signatures of the two directors whose signatures were required and had fraudulently affixed the seal of the company. Here no confidence had been reposed in the secretary and no apparent authority conferred upon him to do the acts occasioning the injury, therefore, the case is not within the class of cases of fraud by the agent in the exercise of acts "within the appearance of the authority conferred upon him." The quotation from Lord Davey's opinion, not being necessary to the decision of the case, must be regarded as dictum. It is apparent, however, that the rules being cited as authority for the proposition uttered by Lord Davey in a case decided by such an eminent tribunal would carry great weight in substantiating the principle as the true English rule.

In the United States the New York courts early took a directly conflicting view. In *New York & New Haven R. R. v. Schwyler*,<sup>23</sup> generally referred to as the leading New York case, the purchasers of stock fraudulently issued by the railroad's agent, in excess of the authorized capital of the railroad, and for the agent's benefit, were allowed to recover damages sustained by such fraud from the railroad company. Although, in this case, there was another element, that of negligence on the part of the railroad company in failing to discover the fraud, which was continuous over a period of seven years, and until the agent became insolvent and resigned from

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23. 34 N. Y. 30.

his position as agent, it is cited as authority for the rule that the principal is liable for his agent's fraud although committed for the agent's benefit. This doctrine has been followed by succeeding cases in New York and other States, many of them much stronger than the principal case inasmuch as the element of negligence is not present in them.

The case of *Fifth Avenue Bank of N. Y. v. Forty-second Street and Grand St. Ferry R. R. Co.*<sup>24</sup> is more in point to the question because there the certificates of stock were not only fraudulently issued by the agent but the signature of the company's president on the certificate was forged by him as well. It was held that the fact that an official signature to the certificate was forged does not extinguish the liability of the company to the innocent person to whom the certificate was fraudulently issued where the forgery had been done by or at the instance of an officer of the corporation, intrusted with the custody of its stock books, and held out by the company as the source of information on that subject.

The doctrine of the liability of the principal for the fraud of his agent in issuing fictitious certificates of stock has been followed, among others, by the courts of Massachusetts,<sup>25</sup> Kentucky,<sup>26</sup> Pennsylvania,<sup>27</sup> Maryland,<sup>28</sup> Minnesota;<sup>29</sup> and in the case of a money order message fraudulently transmitted by an operator employed by a telegraph company the company was held liable for loss occasioned by such fraud.<sup>30</sup>

In Missouri the case of *National Bank of Webb City v. Newell Morse Realty Co.*<sup>31</sup> presented facts somewhat similar to those under judicial investigation in the case of *New York & New Haven R. R. v. Schuyler* (*supra*). In both cases there

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24. 137 N. Y. 231.

25. 150 Mass. 200.

26. 91 Ky. 94.

27. 127 Pa. St. 601.

28. 60 Md. 36.

29. 39 Minn. 181. (Compare with 44 Minn. 224.)

30. 103 Fed. 841.

31. 259 Mo. 637.

had been a fraudulent issue of stock by an agent which was made possible by the negligence of the corporations. The defendant was held liable in the Missouri case, Judge Graves, in delivering the opinion, saying in part: "The rule to be declared is that if the certificate of stock fair upon its face, is, without notice and good faith, bought or taken as collateral, and such certificate turns out to be spurious, then the corporation is liable for the damages occasioned, whether such certificate be fraudulently or negligently put in circulation. In the case at bar there was fraud upon the part of Newell and the grossest negligence upon the part of Newell and Blair, and other officers and directors of the corporation. For these things the corporation itself is liable to the plaintiff."

This doctrine seems to be almost universally followed in the United States, and some of the courts have gone so far as to hold that a bona fide purchaser of a certificate of stock may recover even though his transferor was *particeps criminis* to the fraud of the agent. Thus, it is obvious that where the corporation would have a good defense against the original holder of the certificate, and would be successful in an action to have the certificate canceled, that these rights and equities may be cut off by a transfer of the certificate to a bona fide purchaser for value. This view is founded on the theory that the recitals in the certificate are continuous misrepresentations and that the corporation is estopped from denying them against a person, who in the absence of suspicious circumstances, relied upon them.

The opposite view of the principal's liability, as illustrated in the case of *The British Mutual Banking Co. v. The Charnwood Forest Railway Co.* (*supra*) seems to have been held in England until a comparatively recent date. In 1912 the House of Lords in the case of *Lloyd v. Grace, Smith & Co.*,<sup>32</sup> held that a principal is liable for the fraud of his agent acting within the scope of his authority, whether the fraud is committed for

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32. L. R. 1912 Appeal Cases, 716.

33. 101 U. S. 557.

the benefit of the principal or for the benefit of the agent. In this case the dicta of Lord Bowen in *British Mutual Banking Company v. Charnwood Forest Railway*, and of Lord Davey in *Ruben v. Great Fingall Consolidated*, to the effect that a principal could never be liable where the fraud of the agent was not for the principal's benefit, was expressly overruled as erroneous and not necessary to the decision of either case. The dictum overruled in each of these cases was based on the rule enunciated by Mr. Justice Willes in *Barwick v. English Joint Stock Bank (supra)*, but more especially on the clause "and for the master's benefit." Lord MacNaghten in overruling this dicta, said: "It was contended that Barwick's case is an authority for the proposition that a principal is not liable for the fraud of his agent unless the fraud is committed for the benefit of the principal \* \* \* but I agree with my noble and learned friend, Lord Halsbury, that the case has been misunderstood in late years, and that it does not decide any such proposition \* \* \* and I think it follows from the decision, and the ground on which it is based, that in the opinion of the Court a principal must be liable for the fraud of his agent committed in the course of his agent's employment and not beyond the scope of his agency, whether the fraud be committed for the principal's benefit or not."

Since this case it would seem that the English rule corresponds with that followed in New York in *Schuyler v. R. R.* and succeeding cases in that and other jurisdictions.

It appears quite singular to the writer that the courts are so much more in accord in cases involving the issue by an agent of fictitious stock certificates than in those involving the fraudulent issue of bills of lading. In the first class, the tendency to hold the principal liable seems to be universal in the United States while there is a marked aversion to doing so in the latter class. Sometimes we see the courts in the same jurisdiction holding one way in a case of the first class, and another, and conflicting way, in the second class, although the

principle of law involved is, apparently, the same in both classes of cases.

These cases appear irreconcilable unless there is some inherent distinction in the legal efficacy of bills of lading and certificates of stock. While bills of lading possess some of the attributes of negotiable instruments it has been held that an assignment of a bill of lading by the consignor to the consignee gives the consignee only such rights to the goods of which they are a symbol as were vested in the consignor; *Shaw v. Railroad Co.*,<sup>33</sup> *Saltus & Saltus v. Everett*.<sup>34</sup> On the other hand, it has been held that fictitious stock certificates are so far negotiable that under some circumstances a better title may be given to the shares which they symbolize than that vested in the transferor.<sup>35</sup>

In bills of lading issued without the delivery of goods to the carrier the element of fraud is always present because of the recitals therein that goods have been so delivered, and the consignor, although he might be innocent of any fraudulent intent, would have notice that the recital is a misrepresentation and by assenting to the issue of the bill would be a party to the fraud. It would seem to follow under the rule enunciated in *Shaw v. Railroad Co. and Saltus & Saltus v. Everett (supra)* that the defense of fraud available against the consignor would be available against those claiming through or under him.

A certificate of stock, on the contrary, contains no recitals which could be construed as giving notice of fraud. In cases then where the original subscriber acts in good faith the defense of *participes crimines* would not be available in an action on such a certificate. It would also seem to follow that because the recitals or declarations contained in such certificates are held to be continuing misrepresentations that even in cases where the original subscriber was actually a party

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34. 20 Wendell, 267.

35. Fletcher's Enc. of Corporations, Vol. 5, sec. 3781 and cases cited therein.

to the fraud, such a defense would not be available against a bona fide transferee for value.

This view would reconcile the two classes of cases and justify the apparent conflict in States where the principal is held liable in the certificate cases and not liable in the bill of lading cases.

To the query why the same rule cannot be applied to the recitals in bills of lading the only answer is that the courts, except those which consistently follow the New York rule, in both classes of cases, have held otherwise.

Probably the most that can be said about the subject as a whole is that it is an anomalous question<sup>36</sup> but why the courts do not follow one of the two rules consistently, as the New York courts seem to do, is unexplainable unless, as suggested, there is some inherent difference in the instruments involved.

JAMES C. PORTER, '24.

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36. The question has been settled in the Federal Courts as to bills of lading for interstate shipments by statute (Barnes Federal Code, Sec. 7999). Also as to intrastate shipments in those States in which the Uniform Bills of Lading Act has been adopted; for Missouri law on this subject see R. S. Mo. 1919, Sec. 13545.