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Insurance—Insolvency—General Agent's Right to Set Off Unearned Premiums.—Korlann v. E-Z Pay Plan, Inc. 2

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the dissent's reference to National Bellas Hess' presumably necessary utilization of banking, credit and collection institutions in Illinois to determine the financial circumstances of its Illinois customers who order goods on credit plans.[44] When considered in addition to the fact of regular solicitation by mail of sales in the consumer market, the seller's use of local banking and credit institutions may provide the required nexus to sustain the state's imposition of use tax obligations. Such a practical approach to the facts of mail-order business would offer the Court reasonable grounds for distinguishing *National Bellas Hess* and for reestablishing the reasoning and emphasis of prior use tax cases.

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Insurance—Insolvency—General Agent's Right to Set Off Unearned Premiums.—*Korlann v. E-Z Pay Plan, Inc.*[1]—Manhattan Agencies, Inc. was a general agent which wrote automobile policies on young or "rated" drivers for Superior Mutual Insurance Company and other insurance companies. After a time of consistent dealing with each other, Superior encountered financial difficulties and was declared insolvent. As a result, all policies written for Superior were cancelled. Subsequent to a notice of Superior's insolvency, Manhattan, instead of remitting to the receiver in bankruptcy the full amount of the premiums collected on behalf of Superior, returned that portion of the premiums which became unearned because of the cancellation to E-Z Pay Plan, Inc., as assignee of the policies. E-Z Pay was a finance company which discounted the time payment contracts of Manhattan's customers. On the theory that Manhattan was a trustee for both earned and unearned premiums received from policyholders and, therefore, bound to pay all receipts to Superior's receiver upon notice of Superior's insolvency, an order was directed to Manhattan and E-Z Pay to show cause why Manhattan should not be adjudged to be indebted to Superior for the amount of the unearned premiums and why both Manhattan and E-Z Pay should not be held in contempt for a violation of the liquidation order.

The trial court found that Manhattan was a trustee of both the earned and unearned premiums and that Manhattan was, therefore, a converter of the money returned to E-Z Pay, and E-Z Pay a constructive trustee of the refund for the benefit of Superior's receiver. On appeal by Manhattan and E-Z Pay, the Supreme Court of Oregon HELD: The business conduct of Manhattan and Superior over the years clearly indicates that they were at all times dealing with each other as mutual debtor and creditor, and not as

[44] Bellas Hess could not carry on its business in Illinois, and particularly its substantial credit business, without utilizing Illinois banking and credit facilities. . . . [I]t would . . . be unreasonable to assume that the company does not either sell or assign its accounts or otherwise take measures to collect its delinquent accounts, or that collection does not include local activities by the company or its assignees or representatives.

386 U.S. at 762.

[1] 428 P.2d 172 (Ore. 1967).

trustee and beneficiary, so that Manhattan, as both debtor and creditor of Superior in its own right, was free to set off the unearned premiums following notice of Superior's insolvency and to return them to E-Z Pay.[2]

A determination as to whether Manhattan and Superior were trustee and beneficiary or debtor and creditor is of threshold importance because it is well established that one holding money for another as trustee may not set off and retain this money to reduce a debt owed to him personally by the beneficiary of the trust.[3] If, then, Manhattan held the premiums as trustee for Superior, it was obligated to remit the entire sum, both earned and unearned premiums, to Superior even though Superior's insolvency resulted in a cancellation of all its policies. Ordinarily, a cancellation would entitle Manhattan to the unearned premiums for the benefit of its customers. On the other hand, a determination that Manhattan and Superior were debtor and creditor would logically demand at least consideration of the further issue—whether, in the discretion of the court, the setoff by Manhattan of the unearned premiums should be permitted to stand.[4]

According to authorities, the manifested intention of the parties should be the determining factor in defining Manhattan and Superior's relationship.[5] There was, however, no express agreement between them defining their status, nor did Oregon have a statute to aid in interpretation. It was, therefore, incumbent upon the court to look to their established business practices in the light of general principles of insurance practice.

In pursuance of this task, the majority seems to have placed undeserved reliance on at least one aspect of Manhattan and Superior's business practices in reaching its conclusion that they stood in the relationship of debtor and creditor. According to their arrangement for settling accounts, Manhattan was given 70 days after the issuance of a policy to turn over to Superior the premiums due. Its obligation at the end of that time was only for the net premium, so that whenever a policy was cancelled during the regular course of business, Manhattan would credit Superior with the amount of the refund and then pay over to E-Z Pay the unearned premium. No money would move from Superior to Manhattan, but their accounts would show that the refund had reduced the amount due Superior from Manhattan. The majority's emphasis of this accounting practice suggests that it relied on it to some extent to show that Manhattan was entitled to set off unearned premiums after the insolvency of Superior.[6] Since a setoff in bankruptcy is permitted only between mutual debtors and creditors,[7] implicit in such reasoning is the determination that this practice reflects such a debtor-creditor relationship. Although it is not clear, perhaps such a determination was

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2 Id. at 175-76.

3 Downey v. Humphreys, 102 Cal. App. 2d 323, 331, 227 P.2d 484, 490 (1951); Charles W. Virgin Ins. Agency v. Alabama Gen. Ins. Co., 114 So. 2d 524, 525 (Dist. Ct. App. Fla. 1959).

4 Bankruptcy Act § 68, as amended, 11 U.S.C. § 108 (1964) provides for a setoff of mutual *debts* and *credits*.

5 Restatement (Second) of Trusts § 12, comment g (1959); 1 A. Scott, Trusts § 12.2 (2d ed. 1956).

6 428 P.2d at 174-76.

7 See Bankruptcy Act § 68, as amended, 11 U.S.C. § 108 (1964).

reached because Manhattan's control over these unearned premiums indicated to the majority a degree of independence and responsibility which was inconsistent with the concept of a controlled fiduciary.[8]

The dissent criticized the majority's apparent reliance on this offset by adopting a part of Judge Fuld's dissenting opinion in *Bohlinger v. Zanger*.[9] In that opinion Judge Fuld pointed out that when the insurer is still solvent the return of unearned premiums made by an agent upon cancellation of a policy need not be considered anything more than a convenient and expedient way of adjusting the respective interests of the insurer and the policyholders in the collected premiums.[10] According to this reasoning, a solvent Superior would be obligated to return the unearned premiums to the policyholders anyway, so that effecting this result by allowing Manhattan to return the premium can be explained as merely avoiding the useless circuity of requiring Manhattan to remit the unearned premiums to Superior before they are returned to the policyholders. Judge Fuld's point, then, is that this practice by itself indicates neither one way nor the other what relationship existed between parties like Manhattan and Superior because this offset could be utilized in either a debtor-creditor or trustee-beneficiary situation as a convenient way of settling accounts.[11] The analysis is sound; consequently, a practice which can shed no light on the actual relationship of the parties can obviously be of no aid in determining whether Manhattan had a right to a setoff upon a declaration of Superior's insolvency.

The dissent, however, is also guilty of extending principles beyond their effective scope. It maintained that the generally stated principle that premiums paid to an insurance agent constitute a payment to the insurer, and the principle that an agent with authority to collect premiums is ordinarily considered to hold such premiums as a fiduciary for his principal, the insurer, compel a finding that Manhattan held the premiums as a trustee or fiduciary of Superior. The obvious purpose for the principle that payment to the agent is payment to the insurer is, however, to protect the policyholder in the event that the agent does not remit the collected premiums to the company.[12] It does not demand a finding that Manhattan was trustee of the premiums. This principle would still apply whether Manhattan were a representative of Superior to collect the premiums under a contractual duty only to remit a like sum of money at some later date or whether Manhattan were a trustee of the collected premiums. Under either arrangement the policyholder should be protected.

The fact that an agent collecting premiums is ordinarily considered to hold such premiums in trust for his principal, the insurer, is a generalization describing the natural result to be drawn from situations where an agent is

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8 See Bushnell v. Krafft, 133 Ind. App. 474, 485, 183 N.E.2d 340, 346 (1962).

9 306 N.Y. 228, 235, 117 N.E.2d 338, 341 (1954).

10 Id. at 240-41, 117 N.E.2d at 344-45; see 39 Minn. L. Rev. 787, 789 (1955).

11 See Bohlinger v. Zanger, 306 N.Y. at 240-41, 117 N.E.2d at 344-45; 54 Colum. L. Rev. 638, 640 (1954).

12 Transcontinental Oil Co. v. Atlas Assurance Co., 278 Pa. 558, 123 A. 497 (1924); Conniff v. Detroit Fire & Marine Ins. Co., 183 Wash. 496, 48 P.2d 946 (1935); 39 Minn. L. Rev. 787, 788-89 (1955).

authorized to collect money for his principal and is not permitted to treat the collections as his own.[13] In such situations it must be assumed that a trustee-beneficiary relationship is intended. The inference, however, from *Bohlinger v. Ward & Co.*,[14] a case referred to by the dissent, is that the principle has no application where a contrary intention is indicated. In an attempt to explain the *Bohlinger* court's reasons for affirming the finding of a trustee-beneficiary relationship when faced with a similar problem of determining the relationship between agent and insurer, Justice Brennan stated that the case in controversy was not one where " 'the court is able to say that the parties intended [the agent] to have the unrestricted use of the [premium] in the carrying on of its ordinary business and to be liable only to pay a similar amount to the [company].' "[15]

There are two aspects of Manhattan and Superior's business practices which indicate that Manhattan was permitted to treat the collected premiums as its own and therefore should be regarded as a debtor of Superior rather than its trustee. In the instant case, Manhattan was not required to keep premiums collected for Superior in a separate bank account, but rather, with the knowledge and apparent consent of Superior, deposited them in its own general business account from which payment of all Manhattan's obligations was made, including those for operating expenses.[16] Such treatment of premiums does not coincide with the usual concept of a trustee-beneficiary relationship, but on the contrary, would seem to clearly illustrate what is meant by an "unrestricted use of the premiums in the carrying on of its ordinary business."[17]

The arrangement whereby Superior could look to Manhattan for full payment of premiums on policies, whether they were collected or not,[18] is the other aspect of their business practices which indicates that Manhattan was holding the money as its own. Usually an insurance agent is responsible only for those premiums he actually collects from the policyholders.[19] Manhattan's obligation to pay the premiums, whether collected or not, amounts to an extension of its own credit. This would indicate a degree of responsibility and independence consistent with the existence of a debtor-creditor relationship.[20] In referring to a situation where an agent had assumed the obligation to pay premiums 60 days after the issuance of a policy, whether they were collected

[13] Restatement (Second) of Trusts § 12, comment h (1959); 1 A. Scott, supra note 5, at 109. Cf. Boss v. Hardee, 103 F.2d 751, 756 (D.C. Cir. 1939).

[14] 20 N.J. 331, 120 A.2d 1 (1956).

[15] Id. at 335-36, 120 A.2d at 3 (brackets by Justice Brennan).

[16] Brief for Appellant at 18, 428 P.2d 172 (Ore. 1967).

[17] See also Boss v. Hardee, 103 F.2d at 754; Downey v. Humphreys, 102 Cal. App. 2d at 332, 227 P.2d at 490; cf. Brown v. Christman, 126 F.2d 625, 629 (D.C. Cir. 1942). Contra, Garrison v. Edward Brown & Sons, 25 Cal. 2d 473, 154 P.2d 377 (1944); Manufacturers' Cas. Ins. Co. v. Mink, 129 N.J.L. 575, 30 A.2d 510 (1943).

[18] Brief for Appellant at 16-17, 428 P.2d 172 (Ore. 1967).

[19] Bushnell v. Krafft, 133 Ind. App. at 483, 183 N.E.2d at 345; see Elowe v. Superior Fire Ins. Co., 307 Ill. App. 569, 30 N.E.2d 953 (1940).

[20] See Horton v. Eagle Indem. Ins. Co., 86 N.H. 472, 171 A. 322 (1934); Waters v. Wandless, 35 S.W. 184 (Tex. Civ. App. 1896); Lamb v. Connor, 84 Wash. 121, 146 P. 174 (1915). Contra, In re Mason Co., 254 F. 164 (D. Conn. 1918); In re Chandler Ins. Agency, 92 F. Supp. 878 (D. Md. 1950).

or not, and where the companies he dealt with looked to him solely for payment, the court in *Boss v. Hardee*, [21] stated:

> In our opinion the manifest intention of the parties shown by this course of dealing was to establish the relationship of debtor and creditor. Both parties indubitably understood that when premiums were collected appellants [agent] were to have the use of the money in their business for the allowed credit period of 60 days. An understanding of this nature does not create a trust.[22]

In *Korlann*, the dissent maintained that, like the setoff during the regular course of business, the arrangement whereby Manhattan was permitted to deposit the collected premiums in its general business account and whereby Superior could look to Manhattan for payment, whether the premiums were collected or not, can also be explained in terms of convenience and is therefore of no aid in assessing the relationship of the parties. Such an explanation is not acceptable. It has been recognized that the deciding factor in assessing what relationship existed beween Manhattan and Superior was whether Manhattan was permitted to treat the premiums as its own. It has already been shown that the debtor-creditor relationship will be favored where the practices which the dissent discounted are present. In the absence of a statute or agreement, it would be very difficult to imagine stronger evidence indicating an affirmative answer. To adopt the dissent's explanation, therefore, would seem in effect to admit the prior existence of a presumption of a trustee-beneficiary relationship when one does not exist.[23] An examination of the principal cases cited in support of this explanation reveals the source of the dissent's error. In each of these cases there was either an express agreement between the parties making the agent a fiduciary or a statute creating a presumption to the same effect.[24] The issue in these cases was whether the actual practices of the parties were sufficient to overcome the presumption of a fiduciary relationship. In these cases, evidence of complete inconsistency with the presumption was seemingly demanded by the courts to change the expected result.[25] In the present case, however, there is no statute or express agreement between Manhattan and Superior which would create such a presumption and, therefore, Manhattan should not be compelled to meet the same standard of proof.[26]

The result of this analysis, then, is that in the absence of an express agreement between Manhattan and Superior making Manhattan a fiduciary

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21 103 F.2d 751 (D.C. Cir. 1939).

22 Id. at 753-54.

23 See pp. 208-09 supra.

24 Twin City Fire Ins. Co. v. Green, 176 F.2d 532 (8th Cir. 1949) (statute); Garrison v. Edward Brown & Sons, 25 Cal. 2d 473, 154 P.2d 377 (1944) (express agreement); Bohlinger v. Ward & Co., 20 N.J. 331, 120 A.2d 1 (1956) (express agreement).

25 Twin City Fire Ins. Co. v. Green, 176 F.2d at 534-35; Garrison v. Edward Brown & Sons, 25 Cal. 2d at 479, 154 P.2d at 380; Bohlinger v. Ward & Co., 20 N.J. at 335, 120 A.2d at 3.

26 In Bushnell v. Krafft, 133 Ind. App. 474, 183 N.E.2d 340 (1962), the court held that evidence similar to that in this case was sufficient even to overcome the presumption of a fiduciary relationship created by express agreement.

or a statute creating a presumption to the same effect, an arrangement which permits Manhattan to deposit premiums in its own general business account and Superior to look to Manhattan for payment of the entire premium, whether collected or not, provides ample justification for the majority's substitution of a finding that a debtor-creditor relationship was intended rather than the relationship of trustee-beneficiary.

The finding of a debtor-creditor relationship between Manhattan and Superior raises the issue whether Manhattan should be allowed a setoff. In deciding previous setoff questions, the Oregon Supreme Court has looked to Section 68(a) of the Bankruptcy Act.[27] Section 68(a) reads: "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."[28] The only issue of mutuality presented by this case was whether Manhattan and Superior stood in the same capacity.[29] This issue was settled in the affirmative by the finding that Manhattan was both debtor and creditor of Superior in its own right.[30] If only literal compliance were demanded, there would seem to be no question that Manhattan should be allowed the setoff. Despite the unambiguous language of section 68(a), however, a setoff is permissive rather than mandatory and the allowance of a setoff rests with the discretion of the court, sitting as a court of equity.[31] In assessing a court's role where section 68(a) is invoked, the United States Supreme Court in *Cumberland Glass Mfg. Co. v. De Witt & Co.*,[32] stated that the "court has the primary duty of determining for itself whether there are 'mutual debts or credits' that should be set off one against the other according to the true intent and meaning of the Bankruptcy Act."[33]

The dissent's position was that even with the finding of a debtor-creditor relationship a setoff should not be allowed in this case because it would be inequitable and in conflict with the aim of the Bankruptcy Act which is to effect equality of treatment for all creditors.[34] It is clear that if there were no setoff, all policyholders would become general creditors of Superior and entitled to a share of the liquidated assets proportionate to the extent of their claims. A setoff, however, would mean that the claims of some policyholders would be satisfied in full at the expense of others whose distributive

27 See, e.g., Paul B. Emerick Co. v. Wm. Bohnenkamp & Assoc., 242 Ore. 253, 409 P.2d 332 (1965).

28 11 U.S.C. § 108(a) (1964).

29 For a thorough discussion of the mutuality problem, see 4 W. Collier, Bankruptcy ¶ 68.04[2.1] (14th ed. 1964).

30 If Manhattan had held the premiums as trustee for Superior it could not have set them off against a debt owed to it by Superior; for the parties would have stood in different capacities and the requisite mutuality would have been lacking. 3 H. Remington, Bankruptcy § 1451 (rev. ed. 1957).

31 Cumberland Glass Mfg. Co. v. De Witt & Co., 237 U.S. 447, 455 (1915); accord, In re Rosenbaum Grain Corp., 103 F.2d 656, 658 (7th Cir. 1939); Prudential Ins. Co. of America v. Nelson, 101 F.2d 441, 443 (6th Cir. 1939).

32 237 U.S. 447 (1915).

33 Id. at 457.

34 See 3 W. Collier, supra note 29, ¶ 60.01, at 743.

share would be diminished as a result of the reduction in assets. The dissent argued that such a preference should not be enjoyed by some policyholders merely because of the fortuitous circumstance that they dealt with an agency which had not remitted premiums prior to the insurer's insolvency.[35]

The argument lacks merit. In the first instance, an objection based on charges of fortuity and preferential treatment is too general to carry much weight. If a policyholder dealing directly with a company has paid only a part of his premium and becomes a debtor to the company for the balance, he will certainly not be held accountable for the uncollected unearned premiums upon cancellation of his policy caused by the company's insolvency.[36] Yet it is fortuitous that he had not remitted the balance before the company became insolvent. Furthermore, the granting of a setoff will almost always give the party enjoying it a preference over other creditors. This has not, however, prevented it from being favored in bankruptcy.[37] Indeed, the very reason for inserting section 68(a) in the Bankruptcy Act was to show the propriety of allowing such preferences.[38]

The major criticism of the dissent's objection to a setoff, however, is that it completely ignores any interest which Manhattan might have had in the insurance transactions. This oversight is difficult to explain, since it was the dissent which pointed out that policyholders were being preferred only because Manhattan set off the unearned premiums. It was stated that Superior was involved in a business where the risks were high, *i.e.*, insuring young or "rated" drivers. In such a business the possibility of an insurance company becoming insolvent is far from remote.[39] In this context, it must be noted that Manhattan had a recognized interest in protecting its own good will and property right in the continued business of its customers.[40] This interest would be seriously damaged if, upon Superior's insolvency, it could not return to its policyholders the full unearned premiums.[41] Manhattan, therefore, had an interest in these insurance transactions just as real as any policyholder.

With these considerations in mind, a denial of a setoff to Manhattan would appear to be contradictory to the spirit of Section 68(a) of the Bankruptcy Act. Setoffs are allowed in bankruptcy because it is deemed unjust to compel a person who is both a debtor and creditor of the bankrupt to

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35 Similar objections have been stated before. See Charles W. Virgin Ins. Agency, v. Alabama Gen. Ins. Co., 114 So. 2d at 526; Clay v. Independence Mut. Ins. Co., 359 S.W.2d 679, 684 (Mo. 1962); Bohlinger v. Ward & Co., 20 N.J. at 336-37, 120 A.2d at 4; Bohlinger v. Zanger, 306 N.Y. at 241, 117 N.E.2d at 345.

36 See Bohlinger v. Zanger, 306 N.Y. at 233, 117 N.E.2d at 340; 54 Colum. L. Rev. 638, 639 (1954).

37 See, e.g., In re Pottier & Stymus Co., 262 F. 955, 956 (2d Cir. 1919); In re W. & A. Bacon Co., 261 F. 109, 111 (D. Mass. 1919); Moore v. Joseph, 40 S.W.2d 948 (Tex. Civ. App. 1931).

38 Moore v. Joseph, 40 S.W.2d 948 (Tex. Civ. App. 1931); 4 W. Collier, supra note 29, ¶ 68.02[1], at 713.

39 See Kimball, Denenberg & Bertrand, Rehabilitation and Liquidation of Insurance Companies: Delinquency Proceedings in Insurance, 1967 Ins. L.J. 79.

40 See Bushnell v. Krafft, 133 Ind. App. at 485, 183 N.E.2d at 346.

41 Id.

pay his debt to the bankrupt in full and to realize in return only a dividend.[42] It has already been concluded that Manhattan and Superior were debtor and creditor and although the money Manhattan setoff was not its to keep, it would seem equally unfair and unjust to require Manhattan to sacrifice its own business interests and receive nothing in return.

If, then, the propriety of allowing a setoff is to be finally governed by equitable considerations, the result obtained from balancing the equities of the unpreferred policyholders against those of Manhattan and the preferred policyholders would seem to be that any advantage would rest on the side of Manhattan and the preferred policyholders. Therefore, already having obtained literal compliance with the setoff provision of the Bankruptcy Act, there appears to be no substantial reason for disallowing Manhattan's setoff.

In conclusion, although it appears that the majority undeservedly emphasized the accounting setoff during the regular course of business, its final decision was a correct one. The determination of the agent and insurer's relationship is the crucial issue in this kind of case. It is well established that a finding of a trustee-beneficiary relationship forbids an agent's setoff. On the other hand, since there is no substantial imbalance of equities to favor the unpreferred policyholder, a finding of a debtor-creditor relationship should give approval to such a setoff. As indicated, the business arrangement which allowed Manhattan to deposit the premium collection in its own general business account and which allowed Superior to look to Manhattan alone for payment of the premiums in full seemed to clearly warrant the majority's finding of a debtor-creditor relationship and, therefore, Manhattan's setoff of the unearned premiums was properly sustained.

THOMAS R. MURTAGH

Labor Law—Labor Management Relations Act—Section 8(a)(3)—Employer Burden of Proof.—*NLRB v. Great Dane Trailers, Inc.*[1]—Great Dane Trailers, Inc. (hereinafter called Great Dane) and the Boilermakers' Union entered into a collective-bargaining agreement effective by its terms until March 31, 1963. The agreement included a commitment by the company to pay vacation benefits to employees who, in the preceding year, had worked at least 1525 hours. The agreement also provided that, in the case of a "layoff, termination, or quitting," employees who had served more than 60 days during the year would be entitled to pro rata shares of their vacation benefits. This agreement was temporarily extended beyond its termination date. On April 30, 1963, the union gave the required 15 days' notice of intention to strike over issues still unsettled. Subsequently, on May 16, 1963, approximately 350 of the company's 400 employees commenced a strike which lasted until December 26, 1963. During the strike the company continued to oper-

42 See In re Gravure Paper & Board Corp., 150 F. Supp. 613, 614 (D.N.J. 1957); see also Prudential Ins. Co. of America v. Nelson, 101 F.2d at 443.

1 388 U.S. 26 (1967).