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Negotiable Instruments—Rights of Employer's Fidelity Insurer Against Collecting Bank on Employee's Unauthorized Endorsement.—Aetna Cas. & Sur. Co. v. Lindell Trust Co.

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certiorari, but the review is limited solely to the question of whether the participation of a federal Court of Claims judge in the ruling by the Second Circuit invalidates that ruling.[38] If the Supreme Court should invalidate the proceeding, then a retrial is possible, and the court can reexplore the whole legal jungle created by *Glidden*, in which industry, its contracts with labor, and the courts are deeply entangled. But if the Supreme Court sustains Judge Madden's participation, the interpretation of the Second Circuit will stand[39]—that seniority rights to a job, provided for in a contract, and not limited to any specific time or place therein, exist anywhere the employer may be in business, unless waived by the employee or bargained away by his union.

DAVID H. KRAVETZ

Negotiable Instruments—Rights of Employer's Fidelity Insurer Against Collecting Bank on Employee's Unauthorized Endorsement.—*Aetna Cas. & Sur. Co. v. Lindell Trust Co.*[1]—A salesman of the insured, with no authority to endorse checks payable to his employer, endorsed and cashed three checks at the defendant Trust Company which, in turn, collected the amounts of the checks from the drawee bank. Upon learning of the fraudulent transaction, the insured demanded of the Trust Company reimbursement of the total amount of the three checks. The demand was refused, whereupon the insured made a claim against the insurer, Aetna Casualty & Surety Company. The claim was satisfied and, in return, the insured assigned all its right, title, and interest in and to any claims it may have against the Trust Company to Aetna. Aetna brought suit against the Trust Company allegedly for money had and received. The trial court rendered judgment for the defendant, holding that it would be inconsistent to allow Aetna to recover after it had paid the insured on its fidelity bond. In further support of the judgment, the trial court found that Aetna's right to recover was based upon and limited by the equitable doctrine of subrogation. The Court of Appeals reversed. HELD: (1) Insured did not, by demanding and receiving payment from the insurer, make such election as to preclude the insurer from asserting its subrogation right against the

the "runaway" shop. Sidele Fashions, Inc., 36 L.A. 1364 (1961); Address—O—Mat, Inc., 36 L.A. 1074 (1961). But see U.S. Steel Corp., 36 L.A. 940 (1961).

38 The issue raised grows out of the contention that the United States Court of Appeals is a constitutional tribunal, and the United States Court of Claims is a legislative body. The Supreme Court has previously been asked to settle this point as to all the statutory federal courts involved, and the grant of review for this specific purpose means it is ready to do so. If it should decide with the Glidden lawyers that the act of Congress of 1953 attempted unconstitutionally to repudiate the classification (by the Supreme Court in Williams v. United States, 289 U.S. 553 1933), that the Court of Claims was a legislative and not a constitutional court, then the Second Circuit's ruling would be vitiated by Judge Madden's participation.

39 "Should the Supreme Court leave this situation standing, however, it can be corrected by Congress since the grounding of the appeals court decision appears to be in equity and the implications found in long service, not in the Constitution of the United States." Krock, op. cit. supra note 23, at 20.

1 348 S.W.2d 558 (Mo. App. 1961).

bank; (2) insurer's right to recover is not limited by the equitable doctrine of subrogation, but even if so limited, superior equities are in favor of the plaintiff.

In granting relief to the insurer-subrogee, the Missouri court set out numerous principles, both legal and equitable, for its decision. The court first concluded that the substance of the pleading is controlling, and, therefore, notwithstanding that in form the action was for money had and received, the real theory was in tort for conversion. It went on to say that it makes little difference whether the action is for money had and received or for conversion, even though it distinguished cases cited in support of the defendant's argument that election by the insured to receive payment from the insurer precluded the latter from asserting its subrogation claim on the ground that in such cases the actions were for money had and received against a drawee bank rather than in tort for conversion against a collecting bank.[2] In any case, according to the court, the cause of action was not extinguished by payment from the insurer. The assignment of the cause of action was deemed to be a valid transfer recognized at law and unencumbered by equitable principles. Finally, in what appears to be an effort to protect the decision in the event of appeal, the court held that although the insurer does not have the burden of showing superior equities, the evidence sustains the burden, in that in fact the insurer does possess superior equities.

At common law it is held that a bank, which collects checks endorsed by an agent who has no authority, obtains no title thereto and is liable to the true owner for the collection.[3] It should be noted that under the Uniform Commericial Code[4] recovery by the owner from a collecting bank, who has in good faith and in accordance with reasonable commercial standards paid the owner's money on an unauthorized endorsement, is limited to the amount of proceeds remaining in the bank's possession. Whether a payee can recover from a collecting bank no longer in possession of the proceeds would depend therefore upon a deviation from reasonable

[2] The court seems to agree, sub silentio, with the view promulgated in United States Fid. & Guar. Co. v. Fidelity Nat'l Bank, 232 Mo. App. 412, 109 S.W.2d 47 (1937), that the employer of one who without authority cashes a check at the employer's depository bank may *either* demand payment of its money from the bank on the theory that when the bank paid the holder of the check it paid out its own money and not that of the employer, and thus is liable for money had and received *or* affirm payment by the bank and pursue the employee or look to the insurer for reimbursement of the loss occasioned by the employee's defalcation. *Aetna* was distinguished by asserting that the insured's right in tort for conversion against the collecting bank is distinct and independent from the right created by contract against the insurer for losses caused by an untrustworthy employee.

[3] George v. Security Trust & Sav. Bank, 19 Cal. App. 708, 267 Pac. 560 (1928); National Union Bank v. Miller Rubber Co., 148 Md. 449, 129 Atl. 688 (1925); Strong v. Missouri-Lincoln Trust Co. of St. Louis, 263 S.W. 1038 (Mo. App. 1924); Central Trust Co. v. Backsman, 50 Ohio App. 512, 198 N.E. 730 (1935); Bell-Wayland Co. v. Bank of Sugden, 95 Okl. 67, 218 Pac. 705 (1923); Charleston Paint Co. v. Exchange Bkg. & Trust Co., 129 S.C. 290, 123 S.E. 830 (1924); Labor Bank & Trust Co. v. Adams, 23 S.W.2d 814 (Tex. Civ. App. 1930); California Stucco Co. v. Marine Nat'l Bank, 148 Wash. 341, 268 Pac. 891 (1928).

[4] UCC § 3-419.

commercial standards. Had the Code been controlling in *Aetna*, it is doubtful that the defendant would have been liable. The view at common law, however, emphasizes the duty of a bank, whether collecting or drawee, to cash checks only according to the drawer's order, and, as between it and an innocent payee, places absolute responsibility on the former for its unauthorized payment. Thus, in cases where the employer has fidelity insurance, he may look to four sources for reimbursement—the insurer, the collecting bank, the drawee bank or the principal wrongdoer. Where the employer has chosen to pursue the insurer for recovery, some courts have held such election to be a ratification of payment on the check which thereby extinguishes any cause of action against the banks involved.[5] This theory has been effectively attacked and is now of doubtful consequence.[6] It would seem that for the election of remedies doctrine absolutely to preclude recovery from either bank after the insured has been reimbursed by the insurer, legal recognition of the right against the insurer must admit facts which negate the existence of any rights of the insurer against the banks.

Liberty Mut. Ins. Co. v. First Nat'l Bank in Dallas[7] effectively nullified an earlier federal decision[8] by holding that the right to collect from the surety is not inconsistent with the right to proceed against the bank. In *Liberty Mutual*, the position was taken that the indemnity policy does not insure the depositor against loss through acquistion by an employee of the depositor's money, but instead insures the depositor against loss sustained by reason of the dishonest acts of the employee. It was pointed out that the risk insured against is the dishonest acts of the employee and not a breach of duty on the part of the bank. Such reasoning also lends support to the argument that a bank which is primarily liable to the payee should not benefit from an insurance contract to which it has not been a party.[9] The court in *Aetna* took a view similar to that expressed in the *Liberty Mutual*, concluding that recovery by the insured from the insurer does not negate a valid right existing against the collecting bank.

A majority of courts have allowed an insurer to be subrogated to the rights of the insured only when the subrogee is deemed to have superior equities over the defendant.[10] Subrogation, often defined as a creature of

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[5] United States Fid. & Guar. Co. v. First Nat'l Bank in Dallas, 172 F.2d 258 (5th Cir. 1949); American Sur. Co. v. Bank of California, 133 F.2d 160 (9th Cir. 1943); Hensley-Johnson Motors v. Citizens Nat'l Bank, 122 Cal. App.2d 22, 264 P.2d 973 (1953).

[6] Grubnaw v. Centennial Nat'l Bank, 279 Pa. 501, 124 Atl. 142 (1924); Liberty Mut. Ins. Co. v. First Nat'l Bank in Dallas, 151 Tex. 12, 245 S.W.2d 237 (1951).

[7] Supra note 6.

[8] United States Fid. & Guar. Co. v. First Nat'l Bank in Dallas, supra note 5.

[9] Standard Acc. Ins. Co. v. Pellecchia, 15 N.J. 162, 104 A.2d 288 (1954); Grubnaw v. Centennial Nat'l Bank, supra note 6.

[10] American Sur. Co. v. Bank of California, supra note 5; National Sur. Co. v. Arosin, 198 Fed. 605 (8th Cir. 1912); Meyer v. Bank of America Nat'l Trust & Sav. Ass'n, 11 Cal.2d 92, 77 P.2d 1084 (1938); National Cas. Co. v. Caswell & Co., 317 Ill. App. 66, 45 N.E.2d 698 (1942); Louisville Trust Co. v. Royal Indem. Co., 230 Ky. 482, 20 S.W.2d 71 (1929); Southern Sur. Co. v. Tessum, 178 Minn. 495, 228 N.W. 326 (1929); Fidelity & Dep. Co. v. Atherton, 47 N.M. 443, 144 P.2d 157 (1944);

equity, is said to be controlled exclusively by equitable principles, notwithstanding the fact that the insured may have contractually assigned its rights against the bank to the insurer. A minority of courts, as in the instant case, disagree, contending that an assignment of the insured's rights effects a conventional subrogation governed by legal principles.[11] This distinction, at best, is extremely weak and is not generally followed.[12] The rights of an employer's insurer against a defalcating employee are well established in favor of allowing the insurer to recover the amount paid to the insured.[13] In such cases, the equities unquestionably run in favor of the insurer. Where the subrogee, however, seeks to recover from a third party alleged to be a mere innocent conduit in a check cashing transaction, the law is not as well settled.

Under the majority view, recovery by the insurer against a collecting bank has been refused for the reason that the insurer has received compensation for assuming the risk and is therefore not possessed of superior equities.[14] The question of whether the third party is liable is not the controlling determination, but rather the judgment as to which of two innocent parties should bear the loss. Since the insurer is compensated for assuming the risk the argument is made that it should not be allowed to shift the loss to an allegedly innocent third party. Other courts have pointed out that the argument fails to take into consideration that the compensation for assuming the risk is based upon actual losses expected to be sustained by the insurer.[15] Also, the majority in effect permits the collecting bank to benefit from an insurance contract for which it has paid no premiums.[16] If the bank has insurance of its own, its insurer will therefore remain free of any claims arsing out of a risk that it may have assumed. The numerous considerations in deciding which party has the superior equities point up the inevitability of varied results depending on what considerations a particular court may deem important.

The more recent decisions indicate an increasing willingness to allow recovery by an insurer from a third party. In *Standard Acc. Ins. Co. v. Pellecchia*,[17] the Supreme Court of New Jersey allowed the insurer to be subrogated to the right of the employer bank against the collecting bank

United States Fid. & Guar. Co. v. Home Bank for Sav., 77 W. Va. 665, 88 S.E. 109 (1916).

11 First Nat'l Bank of Atlanta v. American Sur. Co., 71 Ga. App. 112, 30 S.E.2d 402 (1944); Grubnaw v. Centennial Nat'l Bank, supra note 6.

12 American Sur. Co. v. Bank of California, supra note 5; Meyer v. Bank of America Nat'l Trust & Sav. Ass'n, supra note 10; Louisville Trust Co. v. Royal Indem. Co., supra note 10.

13 American Sur. Co. v. Robinson, 53 F.2d 22 (5th Cir. 1932); Louisville Trust Co. v. Royal Indem. Co., supra note 10; Vance, Insurance § 134 (3rd ed. 1951).

14 Cases cited note 10 supra.

15 Standard Acc. Ins. Co. v. Pellecchia, supra note 9.

16 In Grubnaw v. Centennial Nat'l Bank, 279 Pa. 501, 505, 124 Atl. 142, 143 (1924), the court said "it would be a novel proposition to hold that an insurance contract could reach out to indemnify a stranger in no way a party to the insurance, whose wrongful act caused the insurance company to pay the loss to the insured which would not have occurred but for the wrongful act."

17 Supra note 9.

on its express guarantee of prior endorsements. The court said that subrogation would be allowed as long as the conduct of the insurer and the insured has not been such as to make the granting of relief unconscionable. The decision, in parting from the majority view, emphasizes the legal liability of the bank to the payee, and permits recovery without regard to comparative equities. In a 1957 decision,[18] the New Hampshire court allowed an insurer to recover from a collecting bank on the ground that the unauthorized payment by the bank caused its equities to be inferior to those of the insurer. The facts of that case are not materially distinguishable from those in other cases holding that an unauthorized payment by a bank is *not* enough to cause its equities to be inferior. The New Hampshire court ruled that the defendant bank was liable for conversion by virtue of a statute,[19] and stated further that the defendant was not found negligent or liable apart from said statute. It appears that the court based its equitable finding on legal considerations and therefore found liability to the insurer more in accordance with principles of law than with principles of equity. In *Aetna*, the decision was based on strict legal principles as well as on equitable principles which tends to indicate a strong willingness to allow absolute subrogation to the rights of the insured. Since there is no serious departure of results under legal principles from objectives of equity and good conscience, it is submitted that a subrogee should stand on the same footing as the subrogor, as was stated by the New Jersey court.[20]

C. RONALD RUBLEY

Partnership—Existing Liability of Retired Partner—Effect of Indemnification Agreement.—*White v. Brown.*[1] —White, one of three partners, retired from a partnership under an indemnification agreement with the continuing partners. Three months later the creditor-appellee was notified of both White's withdrawal and the indemnification agreement. A short time thereafter the creditor accepted from the continuing partners twelve promissory notes, each payable monthly for the principal sum of $2000 with interest at six per cent. These notes were accepted on a debt of $20,659.27 which was incurred by the partnership prior to White's retirement. The continuing partners then became insolvent and the creditor sought payment of the debt from White. The District Court directed a verdict for the creditor.

The retired partner appealed the decision, contending that the evidence was sufficient to submit to the jury on the issue of an implied release agreement. The appellant also maintained that from the evidence presented a suretyship relation could have been inferred, and that the retired partner as surety was discharged from liability on the debt when time for payment was extended. The Court of Appeals for the District of Columbia reversed

18 Security Fence Co. v. Manchester Fed. Sav. & Loan Ass'n, 101 N.H. 190, 136 A.2d 910 (1957).

19 N.H. Rev. Stat. Ann. ch. 337, §§ 21, 23 (1955).

20 Standard Acc. Ins. Co. v. Pellecchia, supra note 9.

1 292 F.2d 725 (D.C. Cir. 1961).