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NOTICE AND THE ENDORSING FIDUCIARY

Edward T. Fagan, Jr.†

It has long been recognized that the "fair haired favorites" of Anglo-American law are the holder in due course and the entity represented by the fiduciary. Indeed, when these two are opposing parties to a controversy involving a negotiable instrument, the apparent clash of notice standards which exist for their protection has led many to the belief that the solution lies only in corrective legislation.¹

The drastic remedy of legislative change is not necessary however to resolve this problem. Originally the two bodies of law incorporating these standards were superimposed because activity governed by one was performed in a field governed by the other. Unfortunately the attempted merger resulted in discord due in part to improper legal analysis and case evaluation. In the opinion of the writer, a proper reconciliation of the apparently conflicting notice standards of the N.I.L. and fiduciary law will demonstrate that there is no justifiable reason for them to be at variance when circumstances dictate their joint application.

The Fiduciary Power Concept

Such a reconciliation is best begun by establishing the concept of fiduciary power. Fiduciaries are representatives

† Professor of Law, St. John's University School of Law.
¹ The Handbook of the National Conference of Commissioners on Uniform State Laws for 1921 shows that banking interests urged the preparation of the Uniform Fiduciaries Act to straighten out the uncertainty in the law regarding the transfer of fiduciaries' and agents' commercial paper.
and as such the act of a fiduciary is a representative act.\(^2\) When activity is offered as representative activity it is obvious that it will not bind the entity so represented unless power exists in the actor to achieve such effect. This power to perform representative activity does not exist because of the fiduciary relation, on the contrary, the fiduciary relation exists because of the acceptance of such power by the named fiduciary.

The power to perform representative activity is therefore the subject of grant. It may come through law by the appointment of an administrator, receiver or guardian, etc.; or it may come from the direct grant of an individual, such as through a power of attorney, a trust instrument or a will. Since the grant establishes the power, the scope of the power is defined by the grant. Unless the power to perform the specific representative act is expressly conferred by law or by grant of an individual, or unless it arises by necessary implication from a grant, the power is nonexistent and any attempted representation without power will not bind the entity unless estoppel can be invoked against it. This power concept of fiduciary law is completely consistent with negotiable instruments law and should not be confused with "abuse of power," which presumes the existence of power. Forgery or unauthorized signature is a real defense under the N.I.L., based on lack of power, and is available against even the holder in due course.\(^3\) Diversion, on the other hand, is a personal defense that recognizes existing power but is based on its improper exercise.

**Agency Authority**

No treatment of the fiduciary power concept is complete unless it takes cognizance of the confusion which has long existed in fiduciary law concerning the power of agents to bind principals in dealings with third parties. The problem,

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\(^2\) Comment \(a\) in Section 13 of the *Restatement of Agency* defines fiduciary as "a person having a duty, created by his undertaking, to act primarily for the benefit of another in matters connected with his undertaking." See also *Restatement, Trusts* § 2, comment \(b\) (1935).

\(^3\) *Negotiable Instruments Law* § 23.
which is as real today as it was in the past, concerns the definition and application of agency authority.\(^4\)

It is not the primary purpose nor aim of this paper to resolve and clarify such confusion, but since it exists, an attempt will be made to redefine authority in order to clearly establish the notice concepts which it embodies, and also to aid in determining the proper application of the fiduciary power concept in situations involving agents signing negotiable instruments.\(^5\)

**Present Definition**

Professor Arthur Linton Corbin, in a comment regarded by some as a "classic on the 'authority' of an agent,"\(^6\) states the currently accepted definition of authority as "an oral or written communication from the principal to the agent, expressing an actual intention that the agent shall act on the principal's behalf in one or more transactions with third persons, or causing the agent reasonably to believe that such was the principal's intention."\(^7\) Under this definition, the distinction between authority and apparent authority lies in the type of the communication. If communicated to the agent, it is authority—if communicated to the third party, it is apparent authority. Apparent authority may therefore coincide with or contradict authority.

**Proposed Definition**

The following definitions are submitted in opposition to the definition of authority as stated above. An agency power,
as distinguished from other types of fiduciary power, is the ability which exists in the grantee of the power to produce a change in a given legal relation involving the grantor of the power, through representative juristic activity performed within a defined area. Consent of the grantor that the agency power exist is a prerequisite for its existence because agency is a voluntary relationship. This consent may only be legally established by an overt manifestation of the grantor since the law is not concerned with "unevinced mental determination." This manifestation of consent is called authority. Authority, properly defined, is the process whereby real agency power is granted through the manifestation by the grantor of his consent that such power exist, whether the manifestation be made solely to the grantee, solely to a third party, or to the grantee and third party jointly. This manifestation can take the form of words, acts or circumstances

8 Strangely enough, no attempt has ever been made prior to this to define "agency power." Writers have uniformly confined their expression to the definition of power without attempting further classification. Section 6 of the Restatement of Agency defines power as "an ability on the part of a person to produce a change in a given legal relation by doing or not doing a given act."

The employment of the term "representative juristic activity" in the definition is in recognition of the distinction made between juristic and nonjuristic acts. Ferson, Principles of Agency 23 (1954); Holland, Jurisprudence 117 (12th ed. 1917); Markby, Elements of Law 124 (5th ed. 1896). Agency power is thereby confined to the ability to transfer to third parties the principal's consent to be bound in legal transactions. Power which the agent has to bind his principal for tortious activity is not agency power but power which comes from either law or from an employment relation.

9 Since agency power, by definition, has been restricted to "representative juristic activity," such ability is the essence of agency itself which cannot exist except at the will and by the voluntary act of the principal. McGoldrick v. Willits, 52 N.Y. 612 (1873); Stringham v. St. Nicholas Ins. Co., 4 Abb. App. Dec. 315 (N.Y. 1867); Roberge v. Monheimer, 21 Misc. 491, 47 N.Y. Supp. 655 (App. T. 2d Dep't 1897); Graves v. Horton, 38 Minn. 66, 35 N.W. 568 (1887); Pole v. Leask, 28 Beav. 562, 54 Eng. Rep. 481 (Rolls 1860), aff'd, 33 L.J. Ch. 155, 8 L.T. 645 (H.L. 1863). See also 1 Mechem, Agency § 211 (2d ed. 1914).

10 Restatement, Agency § 26 and comments (1933).

11 By defining authority as an operative fact rather than as a legal relation, the writer is in accord with Professor Hohfeld who suggests that ambiguity arises in the use of the term when it is defined as a legal relation because of the tendency to blend operative facts with the powers thereby created. Hohfeld, Some Fundamental Legal Conceptions As Applied In Judicial Reasoning, 23 Yale L.J. 16, 44 (1913).

Section 7 of the Restatement of Agency adopts the legal relation concept and defines authority as "the power of the agent to affect the legal relations of the principal by acts done in accordance with the principal's manifestations of consent to him."
as long as they are attributable to the grantor.\textsuperscript{12} The limit of power established by one manifestation may be extended by another manifestation. In such case, authority increases real power.\textsuperscript{13} Once the real power exists, third parties who deal with an agent exercising such power need not establish a reliance upon the manifestation which created the power in order to bind the principal.\textsuperscript{14}

\textsuperscript{12} \textit{Restatement, Agency} §§ 26, 27 (1933).

\textsuperscript{13} In the recent English case of Reckitt v. Barnett, Pembroke And Slater, Ltd., [1929] A.C. 176 (1928), the principal gave a formal power of attorney under seal to the agent. The agent filed a copy of the power with the principal's bank claiming that the power authorized him to draw checks on the principal's account. Since the power did not, in terms, authorize the drawing of checks, the bank justifiably refused to permit the agent to draw on the account. Rather than draw up a new power to include such acts, the principal sent the following letter to the bank:

"Dear Sirs,

Referring to the power of attorney which I have given in favour of Mr. H. James Selborne Woodhouse and which you have inspected, please note that I wish the power to cover the drawing of cheques upon you by Mr. Woodhouse without restriction." \textit{Id.} at 180.

The original of the letter was filed at the bank and the agent was then permitted to draw checks on the account. Thereafter, the agent purchased a car for himself and gave a check drawn on the principal's account in payment. In an action brought by the principal against the payee, the actual authority was construed by the court to include the drawing of checks on the principal's account. The court construed the formal power and the letter to the bank together to determine the actual power. The third party had not relied on either, which ruled out apparent authority. The original grant was thereby increased by a later manifestation made directly to a third party and the result was an increase in real agency power. Recovery was allowed the principal, however, since the court construed "without restriction" in the letter to the bank as not to include issuing checks on the principal's account to pay the agent's private debts. The real power to issue checks did not include the power to issue for other than the benefit of the principal.

\textsuperscript{14} a) A authorized B to buy a horse. A later told C that B had agency power to buy several horses for A. B, learning of the statement A made to C, purchased several horses from D for A. Although D had no knowledge of the manifestations made by A to C, he may hold A to the sale since B was actually authorized to make such purchase. A's subsequent manifestation to C extended A's original grant of agency power to B. See Reckitt v. Barnett, Pembroke And Slater, Ltd., \textit{supra} note 13.

b) Suppose A said to C, "B is my agent for the purchase of a horse." If A has not as yet spoken to B, then the most that exists between A and B is an ostensible but not a real agency. However, a real agency power exists in B to purchase a horse for A by virtue of the grant of power originating from the manifestation of A to C. When B learns of the statement to C, he may purchase a horse for A from any third party, and as such, acts as A's real agent, not merely an ostensible agent, since his exercise of the real power creates a real agency.

Professor Seavey admits that in the above hypothetical case, a real power exists, but he limits it to dealings with the particular person or class of persons
Apparent authority is not authority. Apparent authority, properly defined, is the process whereby an apparent, but not a real, agency power is established through the manifestation by the principal to a third party of consent to the existence of such power, which manifestation contradicts a manifestation of consent to agency power already made by the principal to the agent.\(^{16}\)

*Explanation of Present Definition*

The proponents of an approach which restricts authority to consent communicated to the agent give several explanations for such restriction. Professor Corbin, a spokesman for the present view, admits that it is quite possible to define authority so as to include manifestations of consent made to third parties but not communicated to the agent. "This would unnecessarily complicate the definition, however. The case would seldom happen and there is no presently established usage including such a case."\(^{16}\) It is submitted that this rather arbitrary rejection results in an oversimplification of the definition of authority which in turn is one of the prime causes of the present unnecessary complexity in the law involving apparent authority.

It has been stated that agency power will not exist without the manifested consent of the principal.\(^{17}\) Professor

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\(^{16}\) Comment, *The Authority Of An Agent—Definition*, 34 *Yale L.J.* 788, 793 (1925).

\(^{17}\) See note 9 *supra*. 
Corbin, in support of his definition of authority, contradicts this statement and argues that a real agency power can be established without authority, either real or apparent. Accordingly, its rightful exercise can only be determined by expressions from the principal to the agent. However, the power existing in the cases he uses for illustration is not an agency power, but one created by law. He contends further that a real agency power will exist although based only on apparent authority which conflicts with actual authority. However, when manifestations of consent are contradictory, the latest manifestation to the agent should determine the existence and extent of the real power. The agent being the recipient of the grant, any manifestation to third parties which contradicts, rather than coincides with or extends, the one made to the agent, of necessity is false. No real power should exist in the area of contradiction established by this false manifestation, but the principal should be estopped from denying that an apparent power exists as against those who have relied upon the false manifestation in ignorance of the true manifestation.

The Restatement of Agency, which also predicates authority upon consent communicated to the agent, argues that since agency is a voluntary relationship it is established, as is any other consensual arrangement, by offer and acceptance. Before agency can exist, an offer emanating from the proposed principal must be communicated to the intended agent. Acceptance is of course required but, as in the case

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18 See Comment, supra note 16.
19 The illustrations chosen are cases involving so-called "agency by necessity" wherein the law binds the husband for supplies contracted for by the wife. Actually this may be explained without the aid of agency in that the purchase creates a quasi-contractual obligation against the husband.
20 A controversy has waged through the years as to whether estoppel or the objective theory of contracts should be the controlling feature of apparent authority. See Cook, "Agency By Estoppel," 5 COLUM. L. REV. 36 (1905), and "Agency By Estoppel: A Reply," 6 COLUM. L. REV. 34 (1906); Ewart, Estoppel —Principal And Agent, 16 HARV. L. REV. 186 (1903), and "Agency By Estoppel," 5 COLUM. L. REV. 354 (1905). See also MECHEM, AGENCY §§ 85, 89 (4th ed. 1952). The controversy has overlooked the fact that the grant of agency power is separate from the offer made by the agent to the third party. Once the real power is established, no reliance or estoppel should be necessary to bind the principal. If no real power exists, estoppel is the only solution.
21 RESTATEMENT, AGENCY § 7 (1933).
22 Id. § 15 and comments.
of contractual relations, the manifestation of the principal may be such that it is not necessary for the acceptance to be communicated to him.\textsuperscript{23} Once the necessity of an offer is admitted as a condition precedent to the existence of agency, with the further requirement of communication to the offeree as essential to the establishment of an offer, it is readily seen that the manifestation of consent to agency power must be communicated by the principal to the agent. In line with this reasoning, the \textit{Restatement of Agency} defines agency as "the relationship which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."\textsuperscript{24}

\textbf{Refutation of Present Definition}

If we confine our examination of the problem to the agency power, the error of the \textit{Restatement} and Professor Corbin becomes clear. Neither one has distinguished between fiduciary power in general and a particular type of fiduciary power, namely, agency power. Fiduciary power may be conferred by law or by grant, and certain powers are conferred by law on one who has accepted an agency power.\textsuperscript{25} However, the agency relation which permits representative juristic activity is so personal in nature that present law confines it to voluntary grant and will not recognize its existence in absence of the consent of both parties involved.\textsuperscript{26} It is obvious therefore that an agency power, as distinguished from other types of fiduciary power, must be established by the voluntary grant of a person.

A manifestation of willingness to make a bargain is distinguishable from the voluntary grant of a power. All that is necessary to establish a grant of power is a clear expression

\textsuperscript{23} \textit{Ibid.}.

\textsuperscript{24} \textit{Id.} § 1.

\textsuperscript{25} \textit{Id.} § 12 and comments.

\textsuperscript{26} "...[T]he duties of a fiduciary cannot be thrust upon an unwilling person, so that the relation cannot be created, nor can it continue to exist without the consent of both parties." Seavey, \textit{The Rationale Of Agency}, 29 \textit{Yale L.J.} 859, 863 (1920). It is a contradiction in terms to say that there can be agency created by law. "...[A]ll cases where it is said there is agency created by law are easily disposed of without invoking the relationship of agency." \textit{Ibid.}
of consent that the power exist.\textsuperscript{27} Powers may thus be granted by wills and as such are treated in the same manner as legacies.\textsuperscript{28} The legacy may exist, as may the power, even before the donee or grantee has knowledge of its existence.\textsuperscript{29} A manifestation to a third party of a consent to the existence of agency power, which does not contradict any manifestation already made to the agent, should establish that power regardless of the knowledge of the intended agent, just as the probate of a will automatically establishes a legacy in the donee, or a power of appointment in a grantee.\textsuperscript{30} The

\textsuperscript{27} 4 \textit{Kent, Commentaries} \textsuperscript{*319}.

\textsuperscript{28} Authorities in the field of property jealously guard the concept of power grant, claiming that it is unique to property and as such does not extend beyond a grant by way of deed or will with reference to real or personal property. Professor Tiffany claimed that agency power is different from other powers in that the effective act in the common-law powers under a will is the creation of the power, while in agency the effective act is the execution of the power by the agent as the act of the principal. 1 \textit{Tiffany, Real Property} \textsection{273} (1st ed. 1903).

Professor Seavey has objected to this arbitrary restriction by arguing: “The effective act in both cases is, first the grant of the power, and secondly the execution of it. In agency the creator of the power is usually, probably always, alive when it is executed and an agent is a fiduciary subject to control; but this should affect neither the quality of the power nor the act of its execution.” Seavey, \textit{supra} note 26, at 861 n.9.

Professor Hohfeld has stated: “... it seems clear that the \textit{power} of an agent to convey Whiteacre is not intrinsically different, so long as it endures, from a power to convey Whiteacre in exercise of a so-called power of appointment. ... In truth the creation of a \textit{power of agency} does not necessarily involve any contract rights against the principal or any one else.” Hohfeld, \textit{Fundamental Legal Conceptions As Applied In Judicial Reasoning}, 26 \textit{Yale L.J.} 710, 727 (1917).

Professor Maitland argued that: “The germ of agency is hardly to be distinguished from the germ of another institution which in our English law has an eventful future before it, the ‘use . . . .’” Maitland, \textit{The Origin Of Uses}, 8 \textit{Harv. L. Rev.} 127 (1894).

\textsuperscript{29} Attempts to make the voluntary grant of a power or a devise analogous to an offer which must be accepted prior to existence have uniformly been rejected. The most recent pronouncement on this point was made by the New York Court of Appeals in Matter of Wilson, 298 N.Y. 398, 83 N.E.2d 852 (1949). “A legatee of an unconditional legacy need never formally accept the legacy. If he does not wish it, he must affirmatively renounce it. . . . He may not rid himself of his legacy except by his own affirmative act.

“... If he died it would pass to his distributaries or creditors—even in a case where he did not know of its existence.” \textit{Id.} at 403, 83 N.E.2d at 854.

\textsuperscript{30} Section 87 of the N.I.L., which states that if a note is made payable at a bank, it confers authority upon the bank to pay the note out of funds of the maker on deposit there, is a clear recognition of this fact. It is to be noted, however, that the manifestation on the note which is conveyed to third parties does not create an agency, but confers a real agency power. Agency does not exist until the bank accepts by paying the note. Pease v. Warren, 29 Mich. 9 (1874).
Restatement of Agency admits this, in effect, in its comment concerning power. It states that a power "may exist irrespective of the consent or knowledge either of the one subject to it or of the one holding it. . . . Likewise, a person whom another authorizes to act on his account has a power to bind the other although he has neither legal capacity to bind himself nor the desire to act for the one who has conferred the power upon him." 31

It is true that an offer can be made to grant a power of agency in the event that the intended agent indicates that he would be willing to undertake the activity. In this case the analogy to offer and acceptance is proper and no power exists until the offer is communicated to the intended agent and he communicates his acceptance to the proposed principal. A grant of agency power is easily distinguishable from an offer to make such grant.

It follows from the above reasoning that a real power of agency can be established prior to the creation of an agency relationship. Authority is the method whereby such power is established. Authority is merely the manifested consent of the grantor, the form of such manifestation being the same as that necessary to establish any voluntary grant of power. The intended agent must consent to the power before the agency relationship exists. This consent is established by either an exercise of the power or by a manifestation of consent to its existence. In line with these conclusions, agency is properly defined as the relationship which results from the voluntary grant of a power of representation confined to juristic activity within a defined area to be exercised subject to the control of the grantor and consent by the grantee to the power.

Where a limited or special agency power is granted with a specification in such grant that no further agency power will be permitted, any further grant intended to extend the

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31 Restatement, Agency § 6, comment b (1933).
power will be ineffective until a revocation of the express denial of further power is communicated to the agent. In such cases, when the further grant is attempted by a manifestation to parties other than the agent, the principal may empower the third party or parties to communicate knowledge of the additional power to the agent. When such authorized communication is made, it is the equivalent of a subsequent manifestation to the agent withdrawing the denial of further power and establishing the additional real power.\textsuperscript{32} However, the principal's mere acquiescence to the conduct of the agent forbidden by the original grant will at most establish a ratification of activity already performed and provide the basis of estoppel concerning future activity, for mere acquiescence, in such case, is not a manifestation of actual power.\textsuperscript{33} When no denial of further power is made in the original grant, any further grant merely adds to the original and results in an increase of real power.

**General Agency Power**

 Authorities seem to be in general agreement concerning the impossibility of distinguishing in the individual case between a grant of general agency power coupled with instructions relating to its use within the scope of the business, and a grant of a limited agency power coupled with a denial of further power.\textsuperscript{34} It is uniformly accepted, however, that a general agent may bind his principal by acts within the scope of the business by virtue of apparent authority since third parties are entitled to rely in such case on the appearance of power stemming from the general agency.\textsuperscript{35} Actually, a gen-

\textsuperscript{32} If \( A \) states to \( B \), "You are authorized to buy only one horse for me and no more," and subsequently tells \( C \) that \( B \) has power to buy several horses for \( A \) and further authorizes \( C \) to communicate that fact to \( B \), the communication by \( C \) will be the same as if \( A \) had revoked the original denial and increased the real power. See Restatement, Agency § 26, comment b (1933).

\textsuperscript{33} Kansas Educational Ass'n v. McMahan, 76 F.2d 937 (10th Cir. 1935); Thurber & Co. v. Anderson, 88 Ill. 167 (1878); Ragatz v. Diener, 218 Iowa 703, 253 N.W. 824 (1934); Wheatley v. McRoberts, 157 S.W.2d 803 (Mo. App. 1942); Restatement, Agency § 43 (1933).

\textsuperscript{34} Seavey, Agency Powers, 1 Okla. L. Rev. 3, 16 (1948); Ferson, Principles Of Agency § 152 (1954); 1 Mechem, Agency §§731-35 (2d ed. 1914).

\textsuperscript{35} Seavey, The Rationale Of Agency, 29 Yale L.J. 859 (1920); 1 Mechem, Agency § 739 (2d ed. 1914); Restatement, Agency §§161, 172, 173, 194, 195 (1933).
eral agent does not exist unless a determination is first made that he is empowered to act as such by the principal. Therefore, any attempt to restrict the power of a general agent by boundaries narrower than the scope of the business should be interpreted as an instruction concerning the use of the power within that area. This interpretation would make estoppel unnecessary in cases involving general agents as long as the act is within the general scope of the business.

**Special Agency Power**

Agents who receive a limited power in the first instance are special agents. Apparent authority is applicable in cases where a special agent who has been denied further powers is presented by the principal to third parties as possessing those powers actually denied him. Here real power does not exist but the principal is estopped from proving this fact as against those who rightfully relied upon his false manifestation.

It is submitted that the majority of legal scholars and jurists have not made the proper distinction between authority and apparent authority. This has led to the erroneous conclusion by many that apparent authority, based on reliance, is applicable only in situations involving general agents acting within the scope of the business. The muddle thus created is clarified when it is accepted that manifestation to third parties is one method of granting real agency power and that estoppel, based on objective notice standards, applies to situations involving agents who have been expressly denied further agency power by the principal, or agents who attempt to exercise agency power beyond defined limits.

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36 See the excellent collection of authorities in Note, 5 Mich. L. Rev. 665 (1907). See also Tiffany, Agency § 18 (2d ed. 1924). "They were instructed that, in cases of special agency, one who deals with the agent must inquire into the extent of his authority, but that a principal is bound by all that his general agent has done within the scope of the business in which he was employed, and this, though the agent may have violated special or secret instructions given him, but not disclosed to the party with whom the agent deals. Surely this was correct. . . ." Butler v. Maples, 76 U.S. (9 Wall.) 766, 776 (1869).
One further clarification is necessary. The grant of an agency power with instructions not to reveal the limitations to third parties, or the grant of an agency power the limitations of which are dependent upon facts peculiarly within the agent's knowledge, results in an actual agency power in the agent to represent that the power limit has not been exceeded. This representation of power by the agent, when false, is the equivalent of a false manifestation of consent by the principal. Third parties in these cases may rely upon the expressions of power made by the agent, unless notice exists to the contrary, because he has been actually empowered to make such expressions. A similar result is attained in instances where an individual, who by virtue of his occupation would ordinarily possess a more general power, is employed as a special agent and denied the power he would ordinarily exercise. Professor Ewart refers to the above situations as examples of "estoppel by assisted representation." 38

FIDUCIARY POWER DEFINED

It follows, upon acceptance of the foregoing clarifications, that the total concept of fiduciary power is now subject to concise statement. Fiduciary power is the power to perform representative activity. The fiduciary must be actually empowered to perform the specific act before the act can bind the represented entity, unless estoppel is applicable. Estoppel, which is based on objective notice standards, applies in situations where apparent authority exists in respect to a special agent and in certain instances where attempts are made to exercise fiduciary power beyond its defined limits.


38 Ewart, Estoppel By Assisted Representation, 5 Colum. L. Rev. 456 (1905).
Having established the fiduciary power concept, determination will now be made of its proper application to negotiable instruments. The negotiable instrument drawn by a fiduciary other than an agent merits first consideration. That instrument, when drawn and issued, is a contract. Under fiduciary law, a fiduciary other than an agent is personally liable on the contracts which he undertakes on behalf of the represented entity unless the contract expressly provides otherwise. If such provision is made, then his liability is limited to the assets of the entity as long as the contract is a proper and legitimate obligation. In the event that the claim is improper and the fiduciary has expressly provided against personal liability, he may be sued for breach of implied warranty by the third party. Sometimes a grant of fiduciary power will authorize the fiduciary to borrow money for the benefit of the represented entity. If so, a negotiable instrument issued for a fiduciary loan will also be a legitimate claim against the entity.

Accordingly, before representative contract power can exist in a fiduciary other than an agent, the proposed contract must be proper and necessary for the entity. This does not depend upon the representations of the fiduciary nor on the fact that an actual benefit may accrue to the entity through the execution of the contract. There can never be an apparent, but not real, representative contracting power in a fiduciary other than an agent. The actual manifestation of such power cannot be later contradicted by false power mani-

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39 Cases dealing with bank liability for fiduciary deposits and collections have been omitted in this determination. They have nothing whatever to do with problems of notice in respect to purchase although they are sometimes mentioned in this connection. See in general Merrill, Bankers' Liability For Deposits Of A Fiduciary To His Personal Account, 40 HARV. L. REV. 1077 (1927).
40 NEGOTIABLE INSTRUMENTS LAW § 16.
41 Taylor v. Davis' Administratrix, 110 U.S. 330 (1884).
43 2 SCOTT, TRUSTS § 263.3 (1939).
festations, for only in agency is the source of further fiduciary contract power in the represented entity itself. For this reason, the fiduciary other than agent binds only himself when he draws a negotiable instrument, unless he is drawing it in payment of a legitimate fiduciary expense or pursuant to an express representative power to borrow money.

The acts of drawing and issuing an instrument for a fiduciary loan under a power to borrow, when the fiduciary intends to use the money obtained for his own purposes, are not adverse acts for they result in an initial benefit to the entity by way of receipt of funds. Subsequently the funds are misappropriated, but this is a diversion of proceeds resulting after authorized activity. Conversely, when an agent endorses corporate paper with an intent to use the proceeds for his own purposes, the acts of endorsing and transferring are adverse because they directly deprive the corporation of assets without its consent.

**Statutory Modification of Liability**

Section 20 of the N.I.L. has changed the common law in respect to the liability of the fiduciary who draws a negotiable instrument. As long as the entity which he represents is revealed and he indicates on the instrument that he is signing in a representative capacity, he limits his liability to the assets of the represented entity, provided he is empowered to draw the instrument. On the other hand, if he is not empowered, he is individually liable on the instrument.

**Notice Concepts**

Parties who receive payment from a known fiduciary are not thereby put on notice that he is paying from fiduciary

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45 "Thus an agent may be authorized to give notes for his principal in order to raise money to be used in the business of the latter. A third person may inspect the power, advance the money in good faith, and the agent appropriate it to his own use. In such a case, I should hold the principal responsible, not because the act of the agent appeared to be within the authority, but because the authority actually included the transaction. A power given to an agent to borrow money, upon notes or otherwise, implies that the money may be paid to him, and so the whole transaction is strictly and literally authorized." Mechanics Bank v. New York & N.H. R.R., 13 N.Y. 599, 634 (1856).

46 2 Scott, Trusts § 263.1 (1939).
funds. However, if they have actual knowledge of the fact that such funds are the source of payment, they are charged further with knowledge of the law that the use of such funds by a fiduciary is permissible only in solution of legitimate and proper expenses necessarily incurred by the fiduciary. If the payment does not fall within this description and the expense is considered improper, the entity may compel the party who received the money with such knowledge to make restitution in full, regardless of the hardship that might exist in the individual case.47

It is important to emphasize the fact that notice concepts play no part in the application of the power concept to the negotiable instrument drawn by the fiduciary other than an agent. Notice is only material in the recovery of fiduciary funds used in payment of unauthorized expenses. A check, drawn by a fiduciary who adds to his signature words indicating he signed in a representative capacity, indicates on its face that it is drawn on fiduciary funds. All parties who take such an instrument are placed on notice that the funds may be recovered unless they were used for legitimate expenses. A promissory note made by a fiduciary who indicates his representative status on the face of the note will not give such notice, however, since payment of the note may be made from the fiduciary's personal funds rather than from fiduciary funds.

If the check is drawn by an agent fiduciary who is empowered to draw on his principal's funds for authorized purposes, then, although parties who take such check know from the face of the instrument that fiduciary funds are involved, they are entitled to rely on the representation of the agent that his act of drawing in the specific case is authorized by the principal. No such right of reliance exists, however, if a reasonable man would have decided to the contrary, as in

the instance where the agent uses the check to pay his own
debt and the transferee is aware of this fact.\textsuperscript{48}

\textbf{The Agent Maker, Drawer or Endorser}

The next consideration, in an ascending order of impor-
tance, is the negotiable instrument drawn or endorsed by the
agent fiduciary. Principles of liability deduced from the ap-
plication of the fiduciary power concept in the preceding con-
sideration are inapplicable here, primarily because of the
document of "estoppel by assisted representation." It is the ap-
plication of apparent agency signing power as distinguished
from real agency signing power that causes complications.

Analysis of case law dealing with such instruments es-
tablishes conclusively that the distortion of the doctrine of
apparent authority in this area is one of the roots of the whole
notice problem. Notice rules have been incorrectly applied
in respect to agency signing power. Furthermore, an issue
of constructive notice has arisen in the law of negotiable in-
struments where no such issue in fact should exist. Since
agency involving negotiable paper is ordinarily associated
with corporations in the commercial world, an analysis of
the case law of New York dealing with negotiable corporate
paper is appropriate at this point to prove the above
statements.

Again, the basic approach will be from the point of view
of fiduciary power for it is clear that an agent cannot bind
his principal by drawing or endorsing a negotiable instru-
ment on his behalf unless he is actually or apparently em-
powered to so act.\textsuperscript{49} It is also an elementary principle of

\textsuperscript{48} Lamson v. Beard, 94 Fed. 30 (7th Cir. 1899), \textit{appeal dismissed}, 22 Sup.

\textsuperscript{49} It is a mistake, to suppose that the conventional rule of commercial

\textsuperscript{2} 9 Ct. 939 (1902); Gerard v. McCormick, 130 N.Y. 261, 29 N.E. 115 (1891); 

\textsuperscript{2} 3 Heig v. Caspary, 191 App. Div. 560, 181 N.Y. Supp. 633 (1st Dep't 1920), 

\textsuperscript{2} 3 aff'd mem., 232 N.Y. 574, 134 N.E. 577 (1922); State Bank v. Bache, 162 Misc.

\textsuperscript{2} 3 128, 293 N.Y. Supp. 667 (Sup. Ct. 1937); Martindale v. De Kay, 101 Misc.

\textsuperscript{2} 3 728, 166 N.Y. Supp. 405 (Sup. Ct.), aff'd mem., 180 App. Div. 926, 167 N.Y.

\textsuperscript{2} 3 Supp. 1113 (1st Dep't 1917), aff'd mem., 224 N.Y. 585, 120 N.E. 869 (1918).

\textsuperscript{2} 3 It is a mistake, to suppose that the conventional rule of commercial

\textsuperscript{2} 3 negotiability has anything to do with this question, except in cases where the

\textsuperscript{2} 3 paper carries no notice on its face, that it is made by somebody assuming to

\textsuperscript{2} 3 be an agent. That rule stands upon an arbitrary doctrine of the law-merchant,

\textsuperscript{2} 3 and not at all upon any principle of estoppel. . . But it is a fixed requisite

\textsuperscript{2} 3 of the rule, that the buyer shall be for value \textit{without notice}, and, therefore,
agency law that if this agency power to draw or endorse is not expressly conferred, it will not be implied unless it is absolutely necessary for the exercise of the express powers granted.\textsuperscript{50}

\textit{Policy Question Re Signing Power}

The strict interpretation of this particular grant of agency power is one of the reasons why this paper has emphasized the importance of correctly defining “authority.” Corporate paper makes up a large percentage of the commercial instruments in circulation today. Since the sources of power grants to corporate officials are the corporate charter, by-laws and stockholder or board of director approvals, a heavy burden is placed on business by the requirement that such sources be constantly checked to validate corporate paper. A policy problem therefore arises concerning the power of corporate officials to draw or endorse corporate negotiable instruments. Specifically, the question raised is what should be the extent of the protection afforded third parties who deal with such paper, recognizing its great commercial volume?

\textit{New York Solution}

New York uses two different approaches as a solution. The first approach swings the protection of the law to the third party by determining that officials of at least manufacturing corporations have implied authority to draw or endorse corporate paper on behalf of the corporation.\textsuperscript{51} Third

\begin{itemize}
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parties may rely on such power in absence of actual knowledge to the contrary. This approach is in opposition to established law and is dangerous to employ as a general principle. Recognizing this, the New York courts have tended to limit its application to particular fact situations involving close corporations where the corporate entity is more fiction than reality and the fiduciary is actually the principal. This does not offend fiduciary law.

The second approach is based on an estoppel argument which had its origin in the United States Supreme Court case of Martin v. Webb.\textsuperscript{52} The case held that if, over a long course of dealing, the corporate official endorses or issues negotiable instruments on behalf of the corporation, his signature on such paper will bind the corporation. Since no objection is made by the corporation, it is presumed that although the power to do so was not originally granted, the acquiescence of the corporation with knowledge of such activity gives rise to an apparent signing power which it is estopped from denying. The case permitted estoppel to be invoked by “those who are justified by the circumstances in dealing with its officers upon the basis of that course of business.”\textsuperscript{53} The estoppel can be justified only as to those who have been induced by knowledge of this long course of activity and have relied upon it. If such corporate acquiescence is interpreted as a ratification because facts show notice to it of the unauthorized acts, then the subject matter of the ratification is the prior unauthorized acts performed in relation to the specific parties. Under the traditional doctrine of apparent authority, such ratification does not confer upon the agent real power to act in that manner in the future as no grant of general power to endorse or issue is made directly to him by such ratification. Future activity is governed by the apparent power that arose from the ratification. Estoppel can be invoked only by those who rely on such apparent power. If interpreted as an estoppel based on negligence, because the

\footnotesize{(1890); Bressman, Inc. v. Mosson, 127 Misc. 282, 215 N.Y. Supp. 766 (Sup. Ct. 1926); Ehrlich, Inc. v. Levine, 83 Misc. 136, 144 N.Y. Supp. 818 (Sup. Ct. 1913).}

\footnotesize{\textsuperscript{52} 110 U.S. 7 (1884).}

\footnotesize{\textsuperscript{53} Id. at 15.}
corporation would have known of the unauthorized acts had it used due diligence, then clearly no grant of general power is made governing subsequent activity.

Nevertheless, the New York courts have employed this "course of business" doctrine to protect parties who took such originally unauthorized paper from corporate officials and who in no way were in a position to invoke estoppel since there was a complete lack of knowledge on their part of such "course of business." The legal argument justifying such protection is simple, but it conflicts with the traditional apparent authority doctrine. The case of *Hanover Nat'l Bank v. American Dock and Trust Co.*54 concerned an officer of a defendant warehouse company who had issued negotiable warehouse receipts to his own order. The original grant of power to him did not authorize the issuance of such instruments to himself, but he had done so nevertheless for a period of years with the acquiescence of the corporation. The plaintiff, who had no knowledge of this prior activity, took one of these instruments as collateral security and sought to enforce it. The court admitted that the power had not originally been granted but, relying on the course of business in which he had exercised such power and which was never objected to by the corporation, stated: "under such circumstances the principal is estopped from asserting the truth, by his own conduct in inducing third persons to believe that the agent had due authority to act in the given case." 55 The court then disposed of the fact that the plaintiff had in no way relied on any such past course of business by stating that "... the purchaser of a negotiable instrument, who purchases under circumstances that throw upon him the duty of making inquiry as to its validity, assumes no greater risk by his failure to inquire than the burden of proving that the facts which he could have discovered, had he inquired, would have protected him. (Wilson v. Met. El. R'way Co., 120 N.Y. 145 ...)" 56

54 148 N.Y. 612, 43 N.E. 72 (1896).
55 Id. at 620-21, 43 N.E. at 74.
56 Id. at 622, 43 N.E. at 75. The Wilson case, cited and relied upon so heavily by the court in establishing its argument, merely held that if a real power existed permitting the official to issue or endorse instruments to himself, although circumstances might alert a purchaser to believe otherwise, a failure to investigate would not penalize the purchaser.
Employing this reasoning, if the purchaser had inquired he would have discovered that during a long course of dealing, acquiesced in by the corporation, the official had issued such paper to himself within the scope of business. These facts would have permitted the purchaser to invoke an estoppel had he relied upon them. Reliance was thereby established when in fact it did not exist. This reasoning seems motivated by an awareness that the result would have been unsatisfactory if the traditional doctrine of apparent authority involving estoppel had been applied.

Proposed Solution

This policy question of agency signing power should be resolved by employing the treatment of authority as set forth in this paper. Thus, if the power to draw or endorse negotiable instruments is not originally granted, or if such power is granted but the power to draw or endorse to the official himself is not a part of the original grant, then any later manifestation to third parties or to the agent will be sufficient to establish either of the powers as a real agency power. If the manifestation to third parties is contrary to an express denial to the official of either of such powers, which is a rare occasion, or if there is no manifestation but merely a negligent failure to learn of such unauthorized activity, then no power exists and only those who have rightfully relied on such false manifestation or negligent inaction can claim the existence of an apparent power.

With the above solution, the third party is given the protection intended by the New York courts without distorting fiduciary law in the process. The corporation is adequately protected since it may operate on the assumption that unless such powers are actually granted, they will not be implied from mere official status. The case involving the one-man corporation can continue to be treated as the exception because of the particular facts which make fiduciary law properly inapplicable.
Early New York Decisions Re Signing Power

A distinction was drawn, in the preceding discussion, between the general power of the corporate official to draw or endorse on behalf of the corporation and the power of such official to draw or endorse to himself within the corporate business. It is important to recognize that the second power is not contained in the first by implication. New York law has correctly made this distinction which is predicated upon the general rule of agency that a principal is not bound by a contract executed by an agent in favor of himself unless the principal expressly consents to such activity. Notice concepts are not involved since there is a legal presumption that such power does not exist in absence of affirmative action on the part of the principal to the contrary.

Power to Draw or Endorse to Own Order

This principle was first applied in New York to negotiable instruments in *Claflin v. Farmers' And Citizens' Bank*. There the president of the defendant bank, who had a general power to certify checks on behalf of the bank, certified checks drawn by himself. The court stated:

> It is a necessary and universal implication in all cases of agency, that the power conferred upon the agent is to be exercised for the exclusive benefit of the principal. It is repugnant to the very nature and essence of such power to hold that it may be used for the benefit of the agent in hostility to the interests of the principal. That a trustee or agent shall not act for his own benefit in any matter relating to his agency or trust, is an old and familiar doctrine of the court of equity, frequently asserted in the courts of this country...

It was therefore held that since the president had no power to accept his own checks, the act was a palpable excess of authority and any person taking the paper was bound to inquire as to the power of the agent so to contract.

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57 25 N.Y. 293 (1862).
58 Id. at 296-97.
In *National Banking Ass'n v. American Dock And Trust Co.*,\(^{59}\) which involved the issuance of negotiable paper by a corporate official drawn to himself, the court further discussed the principle as applied to negotiable instruments:

It is an acknowledged principle of the law of agency that a general power or authority given to the agent to do an act in behalf of the principal, does not extend to a case where it appears that the agent himself is the person interested on the other side.

If such a power is intended to be given it must be expressed in language so plain that no other interpretation can rationally be given it, for it is against the general law of reason that an agent should be intrusted with power to act for his principal and for himself at the same time.\(^{60}\)

The principle has been uniformly employed in subsequent New York decisions to date and unquestionably conforms with general business usage and practice.\(^{61}\) It expresses the fact that since the fiduciary's activity is representative, any power which he exercises to benefit other than the represented entity is not fiduciary power and should not be implied from a grant which on its face is purely fiduciary.

**Scope of Signing Power**

Once there is a proper finding in the given case that a real or apparent power exists in the corporate official to draw or endorse in general or to himself, the next step is to determine whether such power has been exercised within its limits. It must be recognized that the existence of agency power is

\(^{59}\) 143 N.Y. 559, 38 N.E. 713 (1894).
\(^{60}\) Id. at 564, 38 N.E. at 714.
\(^{61}\) In Kittredge v. Grannis, 244 N.Y. 168, 155 N.E. 88 (1926), which involved a sale of negotiable bonds by an agent in breach of authority, the court stated: "Here, if Coster, Knapp & Co. had authority to sell the bonds it was to sell them for the benefit of the plaintiff and in his interest. The authority to sell was coupled with this limitation. They sold them for objects beyond the power which had been given them .... Where a sale is authorized by an agent for a specific purpose, as here for the benefit of the plaintiff, the object for which the sale is to be made limits the authority to make it .... The sale by such an agent for his own benefit is more than a mere disobedience of instructions." Id. at 176, 155 N.E. at 90-91. See also Wagner Trading Co. v. National Bank, 228 N.Y. 37, 126 N.E. 347 (1920); Porges v. United States Mortgage And Trust Co., 203 N.Y. 181, 96 N.E. 424 (1911).
contained within its scope for its boundaries are a part of its being. Granted that a real or apparent agency power may exist, it is limited of course to acts performed for the benefit of the principal. It is well to emphasize that acts apparently authorized are only those acts actually performed for the benefit of the principal although not actually authorized. These acts may fall within the scope of an apparent but not a real power.

Adverse Agency Activity

Adverse agency activity was involved in the case of North River Bank v. Aymar. In this case a power of attorney was given authorizing the agent to make or endorse notes in the name of the principal. The agent made and endorsed a series of notes, all outside the scope of the principal's business, for the accommodation of a third party. The opinion stated that the power to make or endorse was limited to notes in the proper business of the principal regardless of whether such limitation was expressed on the face of the power. While admitting that the specific acts of making and endorsing were outside the scope of any power real or apparent covering acts within the business, the court nevertheless held the principal liable on the notes. The decision was not based upon the ordinary doctrine of apparent authority, admittedly inapplicable to the facts, but on the doctrine of estoppel by assisted representation. The court stated:

Whenever the very act of the agent is authorized by the terms of the power, that is, whenever by comparing the act done by the agent with the words of the power, the act is in itself warranted by the terms used, such act is binding on the constituent as to all persons dealing in good faith with the agent. Such persons are not bound to enquire into facts aliunde. The apparent authority is the real authority.\textsuperscript{63}

The particular adaptability of the doctrine to the negotiable instrument drawn or endorsed by the agent was noted in \textit{New York & N.H. R.R. v. Schuyler}:\textsuperscript{64}

\textsuperscript{62} 3 Hill 262 (N.Y. 1842).
\textsuperscript{63} Id. at 270.
\textsuperscript{64} 34 N.Y. 30 (1865).
The contrary doctrine would be singularly inconvenient, if not absurd, in practice. For instance, under a general power to draw bills, which means, of course, only in the business of the principal, no party could safely take a bill drawn by the agent, without pursuing the inquiry, whether it was drawn in such business, to extremes. If the peril is on the party to whom the bill is given, nothing short of personal application to the principal himself can relieve it, for nowhere short of that, is absolute certainty. Every intermediate appearance or representation may be false or deceptive, and the rigid rule of actual authority will be satisfied, with nothing less than absolute verity. So, then, the general power carries no safety whatever, since each bill made under it must be verified as to extrinsic facts, by resort, for perfect security, to the principal himself.65

The employment of the doctrine generally in the law of agency is subject to serious criticism. It has been rejected by many jurisdictions, particularly because it shifts the protection of the law appreciably in favor of parties who deal with agent fiduciaries and is therefore a departure from the fundamental purpose of fiduciary law, which is to protect the represented entity.

The position that the doctrine should at least be made applicable to negotiable instruments is a logical one because of the unique nature of such paper.66 In most situations involving corporate officials who transfer negotiable instruments drawn or endorsed outside the scope of the corporate business, the transferees are aware of the agent's adverse activity. Even if they are not, they are normally the only persons dealing with the paper who are in a position to readily investigate and determine whether the act is within the scope of the power. Yet these parties usually discount the paper rather than face the problem of enforcing it. Subsequent good faith purchasers of such paper should have some degree of protection when agency signing power is exceeded as distinguished from when it never existed, if the negotiable instrument is to be of any value commercially. That such protection is available through this doctrine is demonstrated in Griswold v. Haven.67 There it was stated that:

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65 Id. at 70.
66 See 1 Mechem, Agency §759 (2d ed. 1914).
67 25 N.Y. 595 (1862).
The law merchant gives effect to a negotiable instrument, according to its terms. As those terms import a dealing between the maker and each person to whom the instrument may be transferred, it is so treated. Hence any representation upon the face of paper of this description, is considered as made directly to every one who may become its bona fide holder. (Polhill v. Walter, 3 B. & Ad., 114.). The mere assumption by a partner or agent of power to execute such paper, is a virtual representation to all who may take it of the existence of every fact essential to the power.68

Thus far, the reasoning of the New York courts has been basically sound in the corporate cases in this analysis. Early decisions have properly distinguished apparent authority from situations wherein agents have acted adversely to the principal in signing corporate paper. Consonant with good business policy, protection has been afforded the bona fide purchaser of such paper through the doctrine of estoppel by assisted representation. While notice rules were improperly applied in other early cases, the holdings were in line with a business policy that understandably affords maximum protection within the law to the holders of corporate paper. It has been shown that the same results can be achieved by redefining apparent authority and thus avoiding such technical error. It is submitted, however, that more than mere technical error exists in many later leading New York decisions for they have improperly construed and applied these early foundation principles.

Later New York Decisions

If a corporate official is granted a general power to draw or endorse corporate paper and transfer it within the corporate business, cases such as Cluett v. Couture69 have stated that his act of drawing such paper to bearer or to the order of the corporation or a third party, or his act of endorsing it in blank or to a third party, is always actually authorized and

68 Id. at 602.
only when he names himself payee or endorsee is the act un-
authorized. If further facts show that he is also empowered
to draw or endorse to himself and transfer within the cor-
porate business, all acts of drawing or endorsing on his part
are always actually authorized.

Diversion Versus Signing Power

Holdings based on these conclusions emphasize that the
only consideration is the subsequent transfer. If that trans-
fer is made with the intention of diverting the proceeds of the
paper to the corporate official rather than to utilize them for
the benefit of the corporation, a diversion of the instrument
takes place. Diversion being a breach of trust, any holder
who takes with actual knowledge of such defect in title is not
a holder in due course. The sole issue then is whether the
purchaser had actual knowledge of the diversion at the time
of the negotiation to him.

Erroneous Distinction

It is submitted that the error in this reasoning lies in
the fact that the representative acts of drawing or endorsing
are never actually or apparently authorized unless they are
performed within the scope of the corporate business, pro-
viding that the scope of the power is not extended by a fur-
ther power grant to such official authorizing him to use cor-
porate assets for his own purposes.

The representative act of signing negotiable paper is
meaningless in itself. It becomes meaningful only when con-
sidered in context. It is one of two necessary acts in the
process of issuing negotiable instruments or negotiating order
paper. The real authorization to the corporate official in the
usual case is to issue or negotiate corporate paper within the
scope of business. The authorization of each necessary act
in an authorized process is dependent upon the performance
of the other necessary acts in such process. If the process
itself is unauthorized in the specific case then each act per-
formed to accomplish the process is an unauthorized act.
How then can it properly be determined whether the corporate official's act of drawing or endorsing negotiable corporate paper, in a specific case, is within the scope of a real or apparent power governing such acts? If the subsequent transfer is adverse to the corporate interests and no further power was granted to him to use corporate assets for his own purposes, that fact should be conclusive on the question of whether the act of drawing or endorsing is adverse and therefore unauthorized, since the two acts are a necessary part of one process.

**True Distinction**

Most New York decisions and some legal scholars have refused to distinguish between diversion of the instrument and its unauthorized signing. There is a well established principle of negotiable instruments law that when an agent is entrusted with negotiable paper for a particular purpose, and fraudulently diverts it to another purpose, a person taking such paper or dealing in it in good faith will be protected. This protective principle is applicable in cases where an examination of the instrument reveals that the entrusted party in possession is a holder. It presumes therefore that all the necessary signatures on such instrument have been properly made.

70 Notably Professor Merrill, who states: "It is unquestionable that a forged or unauthorized indorsement is ineffective to destroy the owner's rights, whether under the Negotiable Instruments Act or under the decisions prior thereto. But the agent does have authority to make indorsements in cases of this type; he is unfaithful to his principal, but still he does an authorized act, when he indorses a check in order to devote it to his own purposes." Merrill, *Bankers' Liability For Deposits Of A Fiduciary To His Personal Account*, 40 Harv. L. Rev. 1077, 1083 (1927).


72 In the recent case of Munn v. Boasberg, 292 N.Y. 5, 53 N.E.2d 371 (1944), a check was entrusted to an agent by the drawer principal. The payee was a third party, therefore the agent could not qualify as a holder of the instrument. The check was transferred to the payee in payment of an obligation incurred by the agent. The payee could not qualify as a holder in due course because he should have been aware from the face of the instrument that the one in possession was not the owner and therefore presumptively could not use it for his own purposes.
Under such circumstances the agent holder gains the power to transfer the instrument from the rule of negotiability. The same power exists in a thief or finder of bearer paper. It is a real power, not a fiduciary power, but the exercise of it by a fiduciary may in some instances be a breach of trust. The power is derived from negotiable instruments law and the same law provides that it will not arise if the instrument is restrictively endorsed. A failure to utilize the restrictive endorsement will of course permit the agent to divert the instrument by employing the power gained as a holder under the N.I.L. It is elementary that an unempowered agent cannot create in himself the status of holder, thereby deriving transfer power from sources outside his principal.

Results of Erroneous Distinction

The "Serbonian Bog" into which this branch of the law was plunged by the adoption of this initial error is plainly evidenced in the decisions of the New York Court of Appeals. In Cheever v. Pittsburgh, S. & L.E. R.R. the president of the defendant corporation, who was authorized to make notes for corporate purposes, made a corporate note payable to a third party who was his secretary and transferred it to him without receiving consideration. The secretary endorsed it back to the president, who then pledged it as collateral for a personal loan made to him by the plaintiff's assignor.

The court reasoned that there could be no dispute as to the actual authority of the president to make the note and that the fraud upon the defendant consisted in the wrongful use of it. Since the instrument was valid, a party to whom it was negotiated would be protected unless he had actual knowledge of the defect in title caused by the diversion. It was decided that the assignor lender had no such knowledge

73 "For the purpose of rendering bills of exchange negotiable, the right of property in them passes with the bills. Every holder with the bills takes the property, and his title is stamped upon the bills themselves. The property and the possession are inseparable." Collins v. Martin, 1 Bos. & P. 648, 651, 126 Eng. Rep. 1113, 1115 (C.P. 1797).
74 NEGOTIABLE INSTRUMENTS LAW § 47.
75 150 N.Y. 59, 44 N.E. 701 (1896).
and the defendant was held liable on the note. The test employed in determining such knowledge was stated by the court as:

He is not bound at his peril to be on the alert for circumstances which might possibly excite the suspicion of wary vigilance; he does not owe to the party who puts the paper afloat the duty of active inquiry in order to avert the imputation of bad faith. The rights of the holder are to be determined by the simple test of honesty and good faith, and not by a speculative issue as to his diligence or negligence. The holder's rights cannot be defeated without proof of actual notice of the defect in title or bad faith on his part evidenced by circumstances. Though he may have been negligent in taking the paper, and omitted precautions which a prudent man would have taken, nevertheless, unless he acted *mala fide*, his title, according to settled doctrine, will prevail.\(^7\)

How apparent it becomes that if estoppel were employed, the defendant might well have prevailed! The president was not empowered to draw corporate paper unless it was for the benefit of the corporation. He drew for his own benefit, which fact is conclusively established by the transfer to the secretary for no value. Since the corporate signature was neither actually nor apparently authorized, the corporation could deny liability on the note unless it was estopped in the specific case. The limitations placed on the signing power were such that the president was empowered to represent that he could affix the corporate signature to all notes other than those drawn to his own order. This representation he made by the very act of signing the note.

If the plaintiff's assignor had the right to rely on such representation, the corporation would be estopped from denying the validity of its signature. Since estoppel had to be established against the company before the plaintiff's assignor could qualify as a holder in respect to the company, he could not be treated as a holder in establishing such estoppel. The test was not the one required of a holder, that he have no actual knowledge of a defect in title, but the objective test of the reasonable man used in all instances involving estoppel.

\(^7\) *Id.* at 65, 44 N.E. at 703.
A banker or businessman who is approached by a corporate official seeking a personal loan on the strength of collateral consisting of corporate paper drawn by him to a third party and endorsed back to him personally, would possibly suspect that the official was not empowered to draw such instrument regardless of the representations made by the official. At least the question should go to the jury and the charge should be based on the objective test to give effect to business practice as well as to correctly apply the legal principles involved.

The ink was hardly dry on the foregoing opinion when the court must have realized that the commercial application of the principle it established would seriously weaken corporate business and finance. Corporations, more so than any other represented entity, are in an extremely vulnerable position regarding violations of fiduciary trust because of the great volume of corporate funds and assets which pass daily through the hands of corporate officials.7 Realizing this danger, commerce relies heavily on the fact that title to the assets is not vested in the agent but in the represented entity. It is therefore common business practice to question the signing authority of a corporate official on a negotiable instrument if circumstances in a particular case would alert an ordinary businessman to possible adverse agency activity.

The Cheever decision struck at the foundations of New York business. It no longer permitted business practice to be a material consideration in determining the binding effect of a corporate signature on the one controlling device of all corporate assets—the negotiable instrument. If actual knowledge was to be the substitute for this practice, corporate finance was literally at the mercy of the ignorant and the unscrupulous. Such was an untenable position for the Empire State, but unless the error in the Cheever case was corrected, the problem seemed insurmountable. Hidden away in the decision were several lines of dictum which seemed to run contrary to the holding itself. The court had stated:

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7 See the excellent discussion of the problem by Chester and Edith Rohrlich, *Psychological Foundations For The Fiduciary Concept In Corporation Law*, 38 Colum. L. Rev. 432 (1938).
The holder of a note who has no actual knowledge or notice of a defect in the title, or other equities between the parties, when circumstances come to his knowledge sufficient to put him upon inquiry, is chargeable with knowledge of all the facts that such inquiry would have revealed.\textsuperscript{78}

Four years later, the court, evidently inspired by this dictum, presented a solution which provided even greater protection to the corporate entity than had formerly existed. The pendulum had indeed swung to the other extreme!

The facts in the case of \textit{Rochester & C.T.R. Co. v. Paviour}\textsuperscript{79} were tailored to act as a vehicle for this solution. The treasurer of the plaintiff corporation, who was authorized to sign or endorse corporate paper within the corporate business, gave two checks drawn on a corporate account in payment of premiums on four fire insurance policies. The corporation had no interest in the policies nor was the treasurer authorized to use corporate assets for personal purposes. The recipient of the checks was aware that corporate funds were being used by the official to pay his private debt.

Even if the authority of the treasurer to draw the checks in question is admitted, it is elementary that a fiduciary diverts if he uses the assets of the represented entity for his own purposes. When such diversion occurs, the issue in relation to third parties is strictly one of notice. Actual knowledge of such diversion is established if a party knows that the fiduciary is using such assets and he knows further that it is a personal use. Of course, if the personal use is actually empowered, then this further fact exonerates the fiduciary and makes the other facts immaterial.\textsuperscript{80} Subjective good faith is

\textsuperscript{79} 164 N.Y. 281, 58 N.E. 114 (1900).
\textsuperscript{80} The only caveat in this respect is the trust fund doctrine as applied to corporations which sets an implied limit to the signing power of the corporate official. The assets of a corporation are looked upon as a fund for the benefit of creditors and it is a breach of duty to transfer such assets to stockholders or corporate officials if creditors' rights intervene. Since this equity exists in the creditor of an insolvent corporation, anyone who takes corporate paper drawn or endorsed by an official to himself under circumstances which would alert a reasonable man to an awareness of this existing equity, cannot prove that the corporate signature was authorized since there was no real or apparent power to make it. Reif v. Equitable Life Assurance Soc'y, 268 N.Y. 269.
no protection if there is actual knowledge of facts which in law establish a defense, as there was in the *Paviour* case.

**Commercial Bad Faith Notice Concept**

This obvious approach was not taken by the court for opportunity was at hand to remedy the adverse effect of the *Cheever* decision. Here were facts which made diversion apparent to any reasonable man, yet the party dealing with the corporate official had satisfactorily established his subjective good faith in the lower court. The Court of Appeals stated:

If the defendant knew or believed, or had good reason to believe, that, in giving the checks, Briggs [the treasurer] was appropriating the money of the plaintiff to the payment of his own debt, or one that he treated as his own, he had no right to accept them without inquiry. While he was not bound to be on the watch for facts which would put a very cautious man on his guard, he was bound to act in good faith. (*Second National Bank v. Weston*, 161 N.Y. 520, 526; *Cheever v. Pittsburgh, etc., R.R. Co.*, 150 N.Y. 59, 66.) Even if his actual good faith is not questioned, if the facts known to him should have led him to inquire, and by inquiry he would have discovered the real situation, in a commercial sense he acted in bad faith and the law will withhold from him the protection that it would otherwise extend.\(^8^1\)

Not content with this death blow to the actual knowledge notice standard recognized but misapplied in the *Cheever* case, the court continued:

The facts known to the defendant should have aroused his suspicion and led him, as an honest man, to make some investigation before he accepted the money of a corporation, which owed him nothing, in payment of a claim that he held against some one else. If he had such confidence in Briggs that he was willing to trust him without inquiry, under suspicious circumstances of a substantial character, he must stand the loss, for he failed to discharge a duty required by commercial integrity. . . . Among the heaviest losses in business are those which result from a blind trust in men on account of their standing in the community, without making the investigation required

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197 N.E. 278 (1935); *Ward v. City Trust Co.*, 192 N.Y. 61, 84 N.E. 585 (1908).

by common prudence. . . . One who suspects, or ought to suspect, is bound to inquire, and the law presumes that he knows what a proper inquiry would disclose. While the courts are careful to guard the interests of commerce by protecting the negotiation of commercial paper, they are also careful to guard against fraud by defeating titles taken in bad faith, or with knowledge, actual or imputed, which amounts to bad faith, when regarded from a commercial standpoint.82

There, in black and white to act as a guide post for all who followed, was the objective test of business practice used to determine the status of a holder of a negotiable instrument. Instead of ruling that estoppel could not be invoked because a reasonable man under the same circumstances would not have been justified in relying upon the power representations of the corporate official, the court elected to substitute constructive knowledge for the actual knowledge requirement of the N.I.L. Faulty analysis had caused fiduciary law and negotiable instruments law to finally collide and from that clash had come the commercial bad faith notice concept.

Of equal importance with this notice error was the fact that the court adopted the reasoning which labeled such transfer a diversion of the instrument. If the agent is considered as having the representative power to transfer in such case, he passes legal title to the third party. If such act is labeled "diversion of the instrument," then an equitable right of ownership is all that remains in the principal. Third party equities of ownership are not proper defenses to parties primarily liable on negotiable instruments in the majority of jurisdictions, including New York.83 Under the reasoning of the court, if a note owned by a corporation as payee or endorsee is transferred by a corporate official in abuse of his endorsing power, then since only a diversion of the instrument takes place, a transferee with knowledge of the diversion may enforce it against a maker who has no defense of his own, unless the corporation is made a party to the action. On the other hand, if correct reasoning is employed in such case, the maker is required to set up as a defense the legal

82 Id. at 285-86, 58 N.E. at 115.
83 Britton, Bills and Notes §§ 159, 160 (1943); Comment, 26 St. John's L. Rev. 135 (1951).
title in the corporation, since legal title in a third person is a valid defense in all jurisdictions. Additional protection is thereby given the principal or corporation by availing such entities relief through the maker's defense as well as by independent affirmative action.

For over thirty years both errors continued unchecked, during which time the commercial bad faith notice concept was slowly perfected and divorced from its original narrow confines of fiduciary law. Finally, the Court of Appeals in *Wen Kroy Realty Co. v. Public Nat'l Bank & Trust Co.*\(^{84}\) attempted to wipe out the fallacies which had persisted since the turn of the century. In that case, the plaintiff corporation had authorized its president to manage its business. The president endorsed the corporate name coupled with his name as president to a check made payable to the corporation. He then procured another to sign the blank endorsement as secretary, though in fact he was not the secretary and had no authority to act as such. The president then deposited the check in the defendant bank to the account of another corporation of which he was also president. The defendant collected the check and permitted the withdrawal of the proceeds by the president, who converted them. The plaintiff corporation sued the defendant bank for conversion of the check.

The majority opinion, after first assuming that power existed in the president to endorse and transfer corporate paper, limited such power to transfers made on behalf of the corporation in the course of its business. At this point the court departed from the long line of precedent and stated:

> Whether an indorsement of a check payable to a corporation is an act performed in the course of the corporate business or the conversion of the property of the corporation, is an extrinsic fact particularly within the knowledge of the person authorized to transact that business. In such circumstances an innocent third party may ordinarily rely upon the representations of the agent. (*Farmers & Mechanics Bank v. Butchers & Drovers Bank*, 16 N.Y. 125.) Even if we were to assume that the president of the corporation had actual or apparent authority to indorse checks in the course of the corporate business that rule would have no application here, for the president

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\(^84\) 260 N.Y. 84, 183 N.E. 73 (1932).
of the corporation authorized to transact its business did not represent
that he, acting alone, had authority to indorse this check, nor did he
assume to act as sole agent. . . . The check in question having, there-
fore, been indorsed or transferred without authority, even colorable,
the question of the defendant's good faith or want of notice does not
enter into the case, any more than it would if the check had been in-
dorsed only by the secretary. Lacking authority at inception, the de-
fendant acquired no title to the money and must pay it back to the
plaintiff, the rightful owner. (Standard Steam Specialty Co. v. Corn
Exchange Bank, 220 N.Y. 478.)

How terse yet accurate was this brilliant summary of law which had been misstated for so long a period! Once
again the doctrine of estoppel by assisted representation was
established as the guide in determining the validity of the
signing power of the corporate official. The commercial bad
faith notice concept was discarded since it had no bearing on
a problem which was essentially one of determining extent
of authority. In addition the error regarding diversion of the
instrument was finally corrected.

The dissenting opinion very cogently presented the op-
posing position, supported by arguments which of necessity
were based upon concepts of power and authority in conflict
with those established in this paper.

Incredible though it may seem, the Wen Kroy case was
either completely overlooked or studiously avoided by sub-
sequent New York decisions which continued to cite the
Cluett and Cheever cases as binding precedent. Whatever
the motivation may have been for its lack of recognition, the
fact remains that today the New York courts labor under a
cloud of error and uncertainty in this field which could easily
be dispelled by a re-examination and acceptance of the prin-
ciples laid down in the Wen Kroy and North River Bank
cases.

85 Id. at 92-93, 183 N.E. at 75-76.
86 In Thomson v. New York Trust Co., 293 N.Y. 58, 56 N.E.2d 32 (1944),
the majority opinion followed the Cluett case while the dissenting opinion
argued on the basis of the Wen Kroy holding.
87 It is becoming more and more evident in recent decisions that this cloud
is beginning to extend beyond the fiduciary cases, at least in respect to dictum.
See Manufacturers & Traders Trust Co. v. Sapowitch, 296 N.Y. 226, 72 N.E.2d
166 (1947), wherein the court states: "Nor are the rights of a purchaser
[of a negotiable instrument] to be affected by constructive notice, unless it
THE ENDORSING FIDUCIARY

THE HOLDER FIDUCIARY

The last and most important consideration is the negotiable instrument held by a fiduciary. Again, the application of the fiduciary power concept is the key to an understanding of the dual role played by fiduciary and negotiable instruments law in this situation.

**Estoppel**

Granting its inapplicability to representative contract power, if a fiduciary other than an agent is actually empowered but acts adversely, can the doctrine of estoppel be invoked to create an apparent power for such activity? The adverse act of any fiduciary is not a representative act and should not rightfully be categorized as a fiduciary act. Unless estoppel is applicable, a trustee with a power of sale over trust assets should not be capable of binding the entity if he sells such assets intending to misappropriate the proceeds, for the act of selling in such case is not representative. The principles of law applicable to the agent fiduciary in this respect should be equally applicable to all other fiduciaries.

New York law has answered the question in the affirmative and the reasoning employed has been in line with the majority of jurisdictions and with that of the foremost modern authorities on fiduciary law. The case of *Kirsch v. Tozier* laid down the following general principle:

Persons dealing with a trustee must take notice of the scope of his authority. An act within his authority will bind the trust estate or the beneficiaries as to third persons acting in good faith and without notice, although the trustee intended to defraud the estate, and actually did accomplish his purpose by means of the act in question. It has frequently been held that a person dealing with an executor, administrator or trustee, who, from the nature of his office, or by the

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89. 143 N.Y. 390, 38 N.E. 375 (1894).
terms of the trust, has power to satisfy or transfer the securities of
the estate, or to vary the investment from time to time, is not bound
to go further and ascertain whether in fact the act of the executor or
trustee is justified, and that no breach of trust was intended. It is
sufficient for his protection that he acts in good faith, and if the act
of the executor or trustee is justified by the terms of the power, the
party dealing with him is protected. (Fuld v. Schieffelin, 7 Jo. Ch.
153.).

It should be noted that the court labeled the adverse act
as “within his authority.” Such terminology allows the erro-
reneous conclusion that adverse activity is included in the
doctrine of apparent authority. Actually, a right of reliance
is established, just as in the agency cases, when the trustee is
actually empowered. Such power impliedly authorizes the
fiduciary to represent that he is acting in a representative
manner in its execution. The recognition of the reliance re-
quirement is the recognition of estoppel with its objective
notice standard.

Bona Fide Purchaser

Estoppel greatly simplifies the problem of determining
the bona fides of a purchaser of property from a known fidu-
ciary. One of the protections afforded the represented entity
by fiduciary law is the principle that such purchasers must
make inquiry at their peril as to the right of the fiduciary
to make the transfer. In respect to such right, the legal pre-
sumption is that it does not exist in a trustee with respect to
trust properties; hence one who alleges that a trustee is au-
thorized to sell must first prove the existence of dispositive
power.\(^1\) On the other hand, executors, administrators and
guardians, in absence of statute, generally have full power to
sell the personal estate under their charge and purchasers
from them need not establish it when proving authority.\(^2\)
The simplification of the duty of inquiry lies in the fact that
once it is shown that selling power exists in the fiduciary,

\(^90\) Id. at 395-96, 38 N.E. at 376-77.
\(^91\) Duncan v. Jaudon, 82 U.S. (15 Wall.) 165 (1872); Geyser-Marion Gold
Mining Co. v. Stark, 106 Fed. 558 (8th Cir. 1901).
\(^92\) See 1 Perry, Trusts and Trustees § 225 (7th ed. 1929).
the doctrine of estoppel ordinarily protects such purchaser in the event that the fiduciary acts adversely in making the sale.

**Holder Selling Power**

When these principles of fiduciary law are applied to a negotiable instrument offered for sale by a fiduciary, it becomes apparent that the duty of inquiry required of its purchaser by fiduciary law is satisfied by an examination of the instrument. Since the sole question is whether the fiduciary has a power of sale, any purchaser should be aware of the fact that negotiable instruments law gives selling power to a holder, even a fiduciary holder, for this is the core of the rule of negotiability. If the instrument reveals that the fiduciary is its payee or endorsee, or that it is bearer paper, then the prospective purchaser has actual knowledge of the fiduciary's actual power to sell such instrument either by adverse or representative act.

It was held by some early cases that if an instrument established the holder as a fiduciary payee or endorsee, that fact was notice to all that he held restrictively and as such could not further negotiate the instrument. These holdings were rejected by an overwhelming majority of cases and the holder fiduciary was firmly established in negotiable instru-

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93 "The fact that the word 'trustee' is on the face of the note does not put the purchaser to any inquiry beyond ascertaining whether the trustee has the power to sell or otherwise dispose of it." Owens v. Nagel, 334 Ill. 96, 165 N.E. 165, 167 (1929).

94 "Ordinarily, one in possession of a negotiable instrument has the power to dispose of it. Certainly, where the one in possession is the payee on the face of the instrument, even in a trust capacity, he has the right in such capacity to negotiate it." Quanah, A. & P. Ry. v. State Bank & Trust Co., 127 Tex. 407, 93 S.W.2d 701, 704 (1936).

A distinction has been drawn between "holder selling power" and "the apparent power of one who sells to a bona fide purchaser." "The divested owner is a party to the transfer as a kind of undisclosed principal of a power conferred on the seller by his own act or acquiescence, in clothimg him with the external indicia of title or authority. In some exceptional cases such as money, market overt where a thief or finder can give title, and negotiable instruments, the power is one conferred by law to facilitate ready transfer on the strength of possession." Ballantine, *Purchase For Value And Estoppel*, 6 MINN. L. REV. 87, 122 (1922).

95 Third Nat'l Bank v. Lange, 51 Md. 138 (1878); Hazeltine v. Keenan, 54 W. Va. 600, 46 S.E. 609 (1904).
ments law as one who had real power to sell in his own right. Notice of fiduciary holding did not terminate negotiability and, at least with reference to purchase, the fiduciary title was treated as surplusage.

It was also held that although negotiability was not terminated by an endorsement to a fiduciary, the holder in such case was a restrictive endorsee and took only the rights of his restrictive endorser. This view has received severe criticism. The more logical view is that the fiduciary endorsee holder may be a holder in due course although his endorser was not. It may be argued, therefore, that the fiduciary payee or endorsee of a negotiable instrument has the full status of a holder under the N.I.L., with no restrictions on his actual selling power.

The legal world was made fully aware of the completeness of holder selling power by the famous article of Professor Chafee, Rights In Overdue Paper, published in 1918. The article establishes that even a thief can pass legal title to a negotiable instrument payable to bearer or endorsed in blank because such thief is a holder under the N.I.L. It rejects Professor Ewart's claim that wrongdoing holders pass

96 See, e.g., Davis v. Garr, 6 N.Y. 124 (1851); Central State Bank v. Spurlin, 111 Iowa 187, 82 N.W. 493 (1900); American Surety Co. v. Multnomah County, 171 Ore. 287, 138 P.2d 597 (1943); Ford v. H. C. Brown & Co., 114 Tenn. 467, 88 S.W. 1036 (1905); Tradesmen's Nat'l Bank v. Looney, 99 Tenn. 278, 42 S.W. 149 (1897); Fox v. Citizens' Bank & Trust Co., 37 S.W. 1102 (Tenn. Ch. App. 1896); Dollar Sav. & Trust Co. v. Crawford, 69 W. Va. 109, 70 S.E. 1089 (1911).

97 The fact that notice of fiduciary holding does not terminate negotiability has led some to believe that it in no way affects due course holding. Professor Britton states: "The general rule is that the purchaser, though not a holder in due course as regards the equity of ownership of the defrauded cestui que trust or the principal, may be a holder in due course as regards equities of defense of obligors on the instrument." BRITTON, BILLS AND NOTES 488 (1943). See also 2 SCOTT, TRUSTS § 297.6 (1939).

98 Gulbranson-Dickinson Co. v. Hopkins, 170 Wis. 326, 175 N.W. 93 (1919).


100 31 HARV. L. REV. 1104 (1918).
only an apparent title created by estoppel.\textsuperscript{101} Professor Chafee's position is that "the legal title to a negotiable instrument throughout its existence belongs to the person to whom the promises run by the terms of the instrument if he has possession, no matter how that possession came to him."\textsuperscript{102} His estoppel rejection would have been strengthened had he noted the fact that the N.I.L. requires actual knowledge of a wrongdoing holder's title defect as notice of such fact, rather than the estoppel requirement of knowledge which would alert a reasonable man.

\textit{Trust Law Conflict}

Strangely enough, holder selling power is a fact which trust authorities seem to have completely disregarded. This is unfortunate because trust law has been the primary guide in decisions involving controversies wherein the purchaser from a fiduciary holder is an opposite party to the represented entity. It has been explained that the reasoning of the cases which establish the fiduciary holder's power of sale is limited to cases in which the represented entity is not a party, and it is only in such cases that the actual knowledge notice requirement of the N.I.L. is applicable.\textsuperscript{103} However, notice of fiduciary breach of trust should be a material consideration in any suit involving an instrument negotiated by a holder fiduciary, whether the represented entity is or is not involved. It is inconsistent to say that the type of notice depends upon who is the plaintiff and that a party's good faith in a transaction already terminated depends upon whether he is suing or being sued at a later date.

In spite of this inconsistency, the prevailing view today is that a prospective purchaser of negotiable paper from a trustee holder has a duty, in respect to the represented entity, to determine whether a power of sale exists in such transferor because he has knowledge of facts which would alert a rea-

\textsuperscript{101} See Ewart, \textit{Negotiability And Estoppel}, 16 L.Q. Rev. 135 (1900).
\textsuperscript{102} Chafee, \textit{supra} note 100, at 1112.
\textsuperscript{103} See Meyer Milling Co. v. Strohfeld, 222 Mo. 1194, 4 S.W.2d 864, 865 (1928).
sonable man to make investigation. A standard text on trust law which has been widely quoted in cases dealing with this point states:

Of course knowledge on the part of the purchaser, that the executor or administrator is dealing with the assets in a fiduciary capacity, is not enough to raise any suspicion, for the reason that it is the duty of the administrator to dispose of the assets and settle the estate; and so a trustee may sell and transfer absolutely the personal property of his trust, if he have power to vary the securities; and if he sells and transfers notes, stocks, or other securities standing in his name as trustee, the purchaser, from that fact alone, cannot be held as a constructive trustee, although the trustee in fact transfers such securities in order to obtain money for his own personal use. The mere fact that the word "trustee" is on the face of the securities cannot put a purchaser to any inquiry beyond ascertaining whether the trustee has power to vary the securities. If he has such power, a purchaser in good faith will be protected, although the trustee use the money for his private purposes.

In refutation of the above reasoning, it is submitted that the sale itself by the holder fiduciary should not be treated in trust law as a representative one. The purchaser is entitled to disregard the fiduciary title because of the fiduciary's real selling power as a holder. Rules governing the bona fide purchase of trust property are not applicable to this purchase because in law the sale itself is treated as personal and not representative. It is true of course that the purchaser is aware of the fact that he is dealing with a fiduciary but this knowledge only charges him in fiduciary law with a duty to avoid conscious participation in a breach of trust.

The reason why it is of prime importance to recognize that the power of sale in the fiduciary holder is more than a fiduciary power lies in the fact that if his power depended solely on the representative power conferred upon him by fiduciary law, estoppel would be the only remedy in the event that his act of selling was adverse. Consequently, if a reasonable man should have been aware from the circumstances

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108 Perry, Trusts and Trustees § 225, at 395-96 (7th ed. 1929).
that the holder fiduciary was acting adversely in selling the instrument, a transferee who took in subjective good faith would have no right to rely on the representations of the fiduciary that the representative power was correctly exercised. But when the fiduciary is a holder, and as such is capable of passing actual title to his transferee, application of the objective notice rule of estoppel conflicts with the actual knowledge requirement of the N.I.L. Estoppel is properly applicable in cases involving agents who lack real signing power. However, if the agent is a holder himself, then he is treated in law as a trustee\textsuperscript{106} and estoppel is no longer applicable because of his real power to sell arising from the N.I.L.

\textit{Trust Law Reconciliation}

Since a conflicting dual notice requirement is inconsistent with right reason, it is submitted that the notice requirement of the N.I.L. should be the sole notice standard in all cases involving negotiable instruments once proper power is established, regardless of the parties involved. This will ensure adequate protection of the concept of negotiability. This may prove unacceptable to trust law authorities who may well argue that right reason can be satisfied by employing the fiduciary law notice requirement as the sole notice standard. If so, then it is further submitted that fiduciary law itself, if properly applied to holder fiduciary cases, would establish the same notice requirement as the N.I.L.

Fiduciary law does not limit participation in a breach of trust to the improper transfer of trust property. Third party liability for such participation depends upon breach of duty. The duty placed upon purchasers is to determine, at their peril, whether the fiduciary has the power to sell. The objective notice standard is applied to purchasers and if only an apparent power of sale exists, the purchaser is protected if a right of reliance can be established. However, once an actual power to sell is present, notice becomes immaterial. The purchaser of an instrument from a holder fiduciary complies with all purchase requirements of fiduciary law because

\textsuperscript{106} Considerant \textit{v.} Brisbane, 22 N.Y. 389 (1860).
the fiduciary has an actual power of sale over the specific instrument at the time it is sold. Nevertheless, observance of one duty will not exonerate a party from liability for participation in a breach of trust if there is failure to comply with another duty.

Participation in a breach of trust may occur otherwise than by improperly receiving transfer of trust property. As stated in the Restatement of Trusts:

If a third person pays or conveys to the trustee money or other property which the trustee as such is authorized to receive, and the trustee misapplies the money or other property, the third person is liable for participation in the breach of trust, if, but only if, when he made such payment or conveyance he had notice that the trustee was misapplying or intending to misapply the money or other property.107

It has already been established that the party who buys from a holder fiduciary knows that the fiduciary is authorized to receive the proceeds of that specific sale since his selling power is unlimited. It is submitted that in such case the only circumstance which can establish notice of misapplication of proceeds, in absence of direct statements of intention made by the fiduciary, is the fact that the fiduciary used the instrument to pay his own debt or to pay for goods or services rendered for his sole benefit. Knowledge of this fact is knowledge in itself of a defense because of the presumption that the fiduciary acts adversely when he acts for himself. Actual knowledge is therefore the notice requirement in such cases.108

Originally the courts required of third parties dealing with trustees the utmost investigation of the trustee's acts. However, this requirement that third parties supervise the conduct of fiduciaries proved intolerable and seriously re-

107 Restatement, Trusts § 321 (1935).
108 “To charge a stranger to a trust fund as a trustee, by reason of participation in a misapplication of the fund, upon the ground that the fund was used in payment of a private debt of the original trustee, it is necessary to show not only that the party sought to be charged was aware that the fund was a trust fund, but also that he was aware that the debt to the payment of which it was applied, was, at the time of such application, in fact a private debt—a debt of such character that the fund in question could not lawfully be applied in payment thereof.” Fifth Nat'l Bank v. Village of Hyde Park, 101 Ill. 595, 604 (1882). See also Perry v. Oerman & Blaebaum, 63 W. Va. 566, 60 S.E. 604 (1908).
tarded the administration of trusts. Consequently, there developed in fiduciary law a trend which today favors an actual knowledge notice requirement for third party liability in breach of trust participation when the problem of purchase is not involved.\textsuperscript{109} Mere negligence in failing to detect adverse fiduciary activity should not make for such liability as long as there is honesty in fact.\textsuperscript{110}

\textit{Uniform Fiduciaries Act}

In line with this trend, the \textit{Uniform Fiduciaries Act} is an ambitious but unsuccessful attempt to bring the law of trusts into conformity with the N.I.L.\textsuperscript{111} The act has been rejected by the majority of states ostensibly because it is too extreme and gives excessive protection to third parties dealing with fiduciaries. Actually, the act is deficient because it fails to distinguish between real and apparent power and draws no clear distinction between the existence of power and its abuse.\textsuperscript{112} These distinctions are of vital importance on the subject of notice and any legislative act relating to fiduciaries is incomplete unless it contains them.

Sections 4, 5 and 6 of the act, dealing with holders of negotiable paper drawn or endorsed by fiduciaries, are the defective sections. As stated by Henry Upson Sims in a recent article on fiduciary law:

\ldots Sections 4, 5 and 6 of the Fiduciaries Act are absolutely destructive of the moral responsibility of businessmen to cooperate in protecting each other against acts of misconduct and fraud on the part of those whom they trust. The author of this article was a member of the committee of the Commissioners on Uniform State Laws which sat in 1921 to draft the Uniform Fiduciaries Act, and he can only

\begin{footnotesize}
\begin{enumerate}
\item See Note, 81 U. Pa. L. Rev. 863 (1933).
\item "To establish joint liability of the bank for the derelictions of the trustee, the plaintiffs must prove that the bank gave to the wrongdoer such assistance as would make the bank a participant in the wrong. Proof that the bank failed in care is insufficient." Grace v. Corn Exchange Bank Trust Co., 287 N.Y. 94, 102, 38 N.E.2d 449, 452 (1941). See Scott, \textit{Participation In A Breach Of Trust}, 34 Harv. L. Rev. 454, 481-82 (1921).
\item See Comment, 24 Colum. L. Rev. 661 (1924).
\item See Bulletin No. 5, Memo. No. 117 of the Committee on the Amendment of the Law, 29 Ass'n Of The Bar Of The City Of New York Reports 166 (1924).
\end{enumerate}
\end{footnotesize}
plead guilty to crass ignorance in not recognizing at the time the enormous blunder of approving all its provisions. Fortunately that Act has been adopted by only twenty-two states.\textsuperscript{118}

**SUMMARY OF NOTICE STANDARDS RECONCILIATION**

From the foregoing analysis the following propositions are deducible:

1. Any transferee of a negotiable instrument drawn by a fiduciary other than an agent cannot enforce the instrument against the assets of the represented-entity unless it was issued pursuant to a power to borrow money for the benefit of such entity or in payment of a legitimate and proper expense necessarily incurred by the fiduciary on its behalf. This is true whether the instrument be bearer or order paper, or whether the named payee is a third party or the fiduciary himself. The doctrine of estoppel is not applicable since there is no basis for any apparent representative contract power.

2. In the absence of apparent authority, any transferee of a negotiable instrument drawn or endorsed by an agent fiduciary in the name of his principal cannot hold the principal liable as maker or claim title against him as endorsee unless the agent has an actual agency power either to perform the specific act of signing or to represent that he has such power. Apparent authority will exist in a given case only if the signing act, although actually unempowered, is performed for the benefit of the principal. In such case, a manifestation to third parties or a ratification that the signing act is empowered must be made by the principal to the knowledge of the transferee or to the knowledge of someone through whom the transferee claims title.

3. If an actual agency power does not exist to perform the signing act in the specific case, the only possible remedy of the transferee is estoppel. Before estoppel can be invoked, it must be objectively established that under the circumstances a reasonable man would have responded in the same manner as the transferee or the one through whom the transferee claims title. If this cannot be done, the right to rely

\textsuperscript{118} Sims, *The Modern Tendency To Relax Protection Of Beneficiaries Against Misconduct Of Fiduciaries*, 3 Ala. L. Rev. 15, 28 (1950).
is non-existent and the claim fails. This objective test is in no way inconsistent with the actual knowledge requirement needed to establish notice under the N.I.L. because the status of holder must first exist before such protection can be claimed. Unless the validity of the corporate or principal's signature is proven, the claimant has not established himself as a holder in respect to such represented entity.

4. When a fiduciary endorses and sells prior to maturity any instrument of which he is the holder and which he himself has not drawn, a strong argument can be made for the conclusion that the purchaser is protected against the property claims and personal defenses of all other parties in such instrument of which such purchaser has no actual knowledge. This is completely consistent with the notice requirements of fiduciary law because the sale was actually empowered and constructive knowledge is not properly applicable in fiduciary law in respect to third party participation in breach of trust when purchase is not directly involved.

5. The doctrine of estoppel only applies to situations involving agent fiduciaries dealing with negotiable instruments.

CONCLUSION

It may therefore be concluded that this reconciliation has achieved its purpose. If the foregoing propositions are followed by the judiciary, the holder in due course of the N.I.L. will be given the protection he was intended to receive by the application of holder selling power. The represented entity of fiduciary law will receive its proper protection because it will only be bound by acts of the fiduciary which are actually or apparently empowered. If actual signing power exists in the fiduciary, then actual knowledge is required to defeat the transfer if the power is abused. If only an apparent signing power exists, and this is applicable only to the agent fiduciary, then constructive knowledge may defeat the transfer because estoppel is the basis of apparent power. The apportionment of protection thus afforded is completely in line with acceptable socioeconomic viewpoints, and has been accomplished without the sacrifice or compromise of any of the principles of reasoning applicable to notice in either of the two bodies of law.