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BILLS AND NOTES—1956 TENNESSEE SURVEY

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Issuance of Checks by Agent in Excess of Authority—Estoppel of Principal to Set Up Want of Authority as Against Holders of the Checks

Section 23 of the Negotiable Instruments Law, adopted in all of the forty-eight states,[1] provides: "When a signature is forged or made without the authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature, unless the party, against whom it is sought to enforce such right, is precluded from setting up the forgery or want of authority."[2] In *Nashville Trust Co. v. Southern Buyers*[3] the Tennessee Court of Appeals was faced with the question whether a principal was "precluded from setting up the want of authority" of his agent who drew several checks on the principal's bank account for the agent's own personal use. In short, the agent misappropriated the principal's funds. The unfaithful agent had been given express authority to draw checks on the account of his principal. This authority authorized the agent to draw all the checks for the principal (a corporation), including checks to himself for his salary and his bonuses. After being employed by his principal for nearly two years, the agent began a scheme for cheating his principal. He accomplished this purpose by drawing several checks on his principal, payable to himself, and then cashing them or depositing them to his personal account in the complainant bank. Most of these deposits were then checked out. The principal discovered that the agent had absconded and stopped payment on two checks which the agent had drawn on principal and deposited with complainant. Complainant filed suit against the principal to recover the amount of the two checks on which defendant had stopped payment. Defendant cross-claimed for the amount of those checks which the agent had wrongfully drawn on defendant's account and which complainant had paid to the agent by cash or by deposits to the agent's account which deposits the agent had checked out.

The court of appeals thought the answer to the claim of both the complainant and defendant hinged on whether defendant-principal was "precluded from setting up the want of authority" of his unfaith-

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1. See 5 U.L.A. 6 (Supp. 1955) for the date when each state adopted the law.
2. NEGOTIABLE INSTRUMENTS LAW § 23; TENN. CODE ANN. § 47-123 (1956).
3. 288 S.W.2d 469 (Tenn. App. M.S. 1956).

ful agent, who misappropriated defendant's funds. Under the facts that appear in its opinion, the court had a sufficient basis for holding that complainant took the checks in good faith and that defendant was precluded from disputing the agent's authority. The facts significantly showed that for about two years defendant permitted his agent to draw checks on defendant in a business in which the agent handled about $100,000 per day, and yet defendant never once examined his bank statements. The court was satisfied that such an examination would have revealed the agent's defalcations.

While an unauthorized signature, such as we have in the case at hand, is inoperative to impose liability and to transfer title to an instrument, nevertheless it is subject to the doctrines of ratification and of estoppel.[4] With respect to an unauthorized signature, section 23 of the Negotiable Instruments Law declares that "it is wholly inoperative," but then the Law goes on to declare that the party whose signature it purports to be may be precluded from setting up the want of authority.[5] The question as to the circumstances under which a signature, which in the first instance is not binding, becomes binding by reasons of the presence of unusual facts, is primarily a question of the law of Agency.[6] Specifically, the questions are: (1) under what circumstances may an unauthorized signature be ratified; and (2) under what circumstances may one be estopped to deny that his signature was unauthorized.

Most of the laws of Agency are not expressly mentioned in the Negotiable Instruments Law, including the usual rules with respect to ratification; but these rules come into the operation of the Negotiable Instruments Law as adopted in Tennessee through the section which provides: "In any case not provided for in this act the rules of law and equity including the law merchant shall govern."[7] Since the court does not rely on the doctrine of ratification in the case at hand, no attempt will be made here to deal extensively with the rules of ratification. Instead, the court holds that the defendant-principal is "precluded" by reason of his own negligence from showing the want of authority of his agent who misappropriated defendant's money. The term "precluded" as used in section 23 of the Negotiable Instruments Law denotes the consequence of an estoppel,[8] but there is some authority that takes the position that the term "precluded" is broad enough to include "ratification."[9] Since there seems to be an

4. See BRITTON, BILLS AND NOTES § 128 (1943).
5. See text and authority cited in note 2 *supra*.
6. See BRITTON, BILLS AND NOTES 558-59 (1943).
7. TENN. CODE ANN. § 47-506 (1956). Tennessee has made a slight change in the Uniform Negotiable Instruments Law by inserting the words "law and equity including." See NEGOTIABLE INSTRUMENTS LAW § 196.
8. BRITTON, BILLS AND NOTES 561 (1943).
9. Strader v. Haley, 216 Minn. 315, 12 N.W.2d 608 (1943). This case gives an exhaustive treatment of the point.

adequate basis for an "estoppel" in the case at hand, it is not necessary to decide whether "precluded" should be used in the broader sense of including "ratification." Defendant's negligence in not examining his vouchers for a period of about two years in a $100,000 per day business appears to be an adequate basis for raising an estoppel against him.[10]

From the facts appearing in the opinion, it also seems that the court correctly decided that the fact this agent drew the checks, made them payable to himself, and then deposited them with complainant, did not charge the complainant with notice of the agent's scheme for cheating his principal. The Uniform Fiduciaries Act, adopted in Tennessee in 1953,[11] would appear to have some application to this case and bolsters the court's decision. Section 6 of the Act provides: "If a check or other bill of exchange is drawn by a fiduciary (includes agent)[12] as such or in the name of his principal by a fiduciary empowered to draw such instrument in the name of his principal, payable to the fiduciary personally, or payable to a third person and by him transferred to the fiduciary, and is thereafter transferred by the fiduciary, *whether in payment of a personal debt of the fiduciary or otherwise,* the transferee is not bound to inquire whether the fiduciary is committing a breach of his obligation as fiduciary in transferring the instrument, and is not chargeable with notice that the fiduciary is committing a breach of his obligation as fiduciary, unless he takes the instrument with actual knowledge of such breach or with knowledge of such facts that his action in taking the instrument amounts to bad faith."[13] (Emphasis added.) In short, where the fiduciary makes a check payable to his own order and indorses the same to the holder (the situation in the case at hand) in payment of his personal debt or otherwise, the form of the instrument itself does not constitute notice of a possible breach of trust by the fiduciary. That is to say,

10. See Britton, Bills and Notes § 132 (1943) and cases cited. The doctrine of estoppel has been invoked quite frequently in connection with forged signatures. See, *e.g.,* Marsh v. State Bank & Trust Co., 163 Tenn. 400, 284 S.W. 380 (1926).

11. Tenn. Code Ann. §§ 35-202 to -214 (1956).

12. "Fiduciary" is defined to include "a trustee under any trust, expressed, implied, resulting or constructive, executor, administrator, guardian, conservator, curator, receiver, trustee in bankruptcy, assignee for the benefit of creditors, partner, agent, officer of a corporation, public or private, public officer, or any other person acting in a fiduciary capacity for any person, trust or estate." Uniform Fiduciaries Act § 1; Tenn. Code Ann. § 35-202 (1956). While there is a paucity of authority on the point, the cases seem to support the conclusion that the agent here would be a fiduciary within the meaning of the Act. Roswell State Bank v. Lawrence Walker Cotton Co., 56 N.M. 107, 240 P.2d 1143 (1952) (purchasing agent was fiduciary within the Act). In Fidelity and Deposit Co. v. Marion Nat'l Bank, 116 Ind. App. 453, 64 N.E.2d 583 (1946) an employee who was authorized to indorse for deposit or negotiation all negotiable instruments and orders for payment of money to employer was a "fiduciary", within this act.

13. Uniform Fiduciaries Act § 6; Tenn. Code Ann. § 35-207 (1956).

the holder is not rendered a bad faith purchaser, and therefore liable, by reason of this form of the instrument.[14]

Complainant could thus actually satisfy the good faith requirement of a holder in due course; and if the other requirements of a holder in due course were met, complainant could qualify as a holder in due course and defendant's personal defenses of fraud and breach of faith are cut off.[15]

Regrettably, there is one feature of the case that calls for adverse comment. After the court decided that the defendant was "precluded from setting up the agent's want of authority to issue and negotiate these checks," the court then concluded by saying that "it follows that complainant became a holder in due course"[16] as to the two checks on which suit was instituted, and is therefore entitled to recover thereon. While, no doubt, the court reaches a correct result in the case, such reasoning simply cannot be supported. One becomes a holder in due course only by reason of the fact that he satisfies all the requirements of section 52[17] of the Negotiable Instruments Law. He does not become a holder in due course by reason of the fact that some other person is estopped to assert his defenses. "Holder in due course" is a term of art, used only in connection with the law of Negotiable Instruments.[18] One may well be estopped to set up a defense where the instrument is not negotiable but he does not thereby become a holder in due course. There is a *non sequitur* in that particular bit of reasoning by the court.

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14. See BRITTON, BILLS AND NOTES 485-86 (1943). This section of the Uniform Fiduciaries Act may change some earlier Tennessee case law. See, *e.g.*, Union Nat'l Bank v. Bluff City Bank, 152 Tenn. 486, 279 S.W. 797 (1925), where the rationale of the holding seems to be that where the fiduciary executes the instrument in the name of his principal as maker or drawer, making it payable to his own order, and negotiates it to his creditor in payment of or as security for his personal debt, the creditor is deemed a bad faith taker. The doctrine of Ford v. H. C. Brown & Co., 114 Tenn. 467, 88 S.W. 1036 (1905), and similar cases, may be changed by section 4 of the Uniform Fiduciaries Act. TENN. CODE ANN. § 35-205 (1956).

15. NEGOTIABLE INSTRUMENTS LAW § 57; TENN. CODE ANN. § 47-157 (1956). By this section a holder in due course holds the instrument free from any defects of title of prior parties and free from defenses of prior parties among themselves; and the holder in due course may enforce payment of the instrument for the full amount thereof against all parties liable thereon. The "defects of title" mentioned in section 57 include "fraud," "breach of faith" and "such circumstances as amount to a fraud," which are found in section 55 of the Negotiable Instruments Law. TENN. CODE ANN. § 47-155 (1956).

16. 288 S.W.2d at 472.

17. NEGOTIABLE INSTRUMENTS LAW § 52; TENN. CODE ANN. § 47-152 (1956).

18. See, *e.g.*, AIGLER, BILLS AND NOTES 331 (1955).