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"When One of Two Innocent Parties Must Suffer by the Act of a Third"

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NOTES

"WHEN ONE OF TWO INNOCENT PARTIES MUST SUFFER BY THE ACT OF A THIRD."*

When a rule or proposition of law is mentioned so often by judges in their opinions that it becomes a common expression, we find it being applied to all like cases without regard

*"When one of two innocent parties must suffer by the act of a third, the party who has enabled such third person to occasion the loss must sustain it."

to the truth or underlying principles of the proposition. Such is the case in the well known expression which is the title of this note. The continuous application of such a proposition has the effect of creating a precedent and often confronts one who may fail to understand the legal principle on which a case should be decided.

After a perusal of the outstanding cases in which the rule has been set forth, it will be found that, although it is referred to as the decisive principle, nevertheless, it can be found from the cases that the courts have actually decided the cases upon entirely different rules of law than the one mentioned.

The purpose of this note, therefore, is an examination of some of the leading cases in which this proposition is announced, in order to show that it is not an established principle of law and that the cases have been actually decided upon other grounds.

The proposition is most frequently mentioned in cases involving the liability of parties to commercial paper, but it is also referred to in cases dealing with the fraudulent acts of agents, and the unauthorized issuance of corporate stock. Many of the cases confuse it with the doctrine of equitable estoppel, and the two rules are sometimes mentioned indiscriminately.

This so-called rule of law originated in the English case of *Lickbarrow v. Mason.*[1] This was a case involving the right of stoppage in transitu as between the consignor and the assignee of the consignee's bill of lading. T. shipped a cargo of corn by boat to Liverpool, four bills of lading being made out, two being given to T., one being sent to F., the consignee, and the other being retained by the master of the ship. T. drew bills of exchange on F. for the value of the cargo. F. negotiated his bill of lading to the plaintiff. F. became insolvent, and the bills drawn on him by T. were

1. 2 T. R. 70.

unpaid. T., upon hearing of the insolvency of F., indorsed his remaining bill of lading over to the defendant, to take possession of the goods upon their arrival in Liverpool. The defendant got possession of the goods and refused to deliver them to the plaintiff who, therefore, brought an action in trover. It was held by the court that T. could have stopped the goods in transitu because of the insolvency of F., but after F. assigned his bill of lading to a third party for value, the right, as between the consignor and such assignee, was gone. It was there said by Lord Ashurst: "We lay it down as a broad general principle, that whenever one of two innocent parties must suffer by the acts of a third, he who has enabled such third person to occasion the loss must sustain it."

It is significant that in the very case in which the doctrine is first enunciated, the court decided the case by laying down a basic principle of the law of sales, and the doctrine which Lord Ashurst referred to was not the ground of decision in the case.

In *Allen v. South Boston R. R. Co.*,[2] the treasurer of the railway corporation fraudulently issued certificates of stock without authority and the purchasers of the stock were allowed to recover from the corporation. The Court said in part of the opinion: "When one of two innocent parties must suffer a loss from the fraud of a third, the loss must be borne by him whose negligence enabled the third person to commit the fraud." In that case the mere mention of negligence is sufficient to make the corporation liable, and the fact that there is negligence takes the case out of the rule which the court attempts to apply as between innocent parties.

In *Friedlander v. Texas & Pacific R. R. Co.*,[3] the railroad was held not liable for the fraud of its agent in issuing a false bill of lading without receiving any goods. Although the court noted the same proposition, the decision was based

2. 150 Mass. 200.
3. 130 U. S. 416.

on the principle of the law of agency, that the principal is not liable for fraud perpetrated by his agent in his individual capacity and not within the scope of his employment.

Again in *New York Iron Mine v. Negaunee Bank*[4] the court spoke of the liability on the part of one enabling another to commit a fraud. But the decision was to the effect that the mere act of conferring an authority that may be properly delegated does not constitute such negligence as to make one innocent party who confers such power responsible for a loss caused to another by the agent's dishonesty; nor can he be responsible if the other party has been negligent.

In *Peake v. Thomas*[5] a husband and wife joined in a mortgage of their farm and the husband later became insolvent. In a foreclosure suit brought by the plaintiff as mortgagee, the wife set up as a defense that, although the mortgage covered the homestead, that the homestead was her separate property and she had signed the mortgage under a misapprehension because she failed to understand the meaning of the description of the land in the mortgage. The Court said: "Whenever one of two innocent parties must suffer by the act of a third, the loss shall be borne by that one whose behavior in the matter denoted to the other that such third person's doings were worthy of trust according to their outward appearance." However, the rule upon which the case is decided is stated later in the case to be: "Whatever may be the actual intention of a party to a transaction, if he so conducts himself in regard thereto as to lead a reasonable person to believe that he understands and assents to its terms, and if the other party so believing fully performs on his part in conformity with the view so indicated, the former is precluded from asserting that he did not understand and assent, and is bound." Thus the actual ground of decision in the case is that the defendant is estopped to deny that the land in controversy was covered by the terms of the mortgage.

4. 39 Mich. 644.
5. 39 Mich. 584.

The ruling as given in the above case and in most of the cases where the proposition appears, is an entirely different doctrine than that originally laid down in *Lickbarrow v. Mason,* supra, and, therefore, does not sustain it.

The doctrine has received no support by the courts of Missouri and was repudiated in the case of *Southern Commercial Savings Bank v. Slattery's Administer.*[6] In that case one Lange executed to Renner eleven promissory notes; one for $20,000 due five years after date, and, ten interest notes for the sum of $600 each. At the same time he executed a deed of trust to secure payment of the notes, whereby certain land was conveyed to a trustee. Renner indorsed the notes without recourse and Lange took possession of them. Lange negotiated the deed of trust and the notes to the plaintiff bank, but it allowed him to keep possession of the deed of trust upon his representation that he would take it to be recorded. He later returned and stated that he had had it recorded and producing a recorder's receipt, said that he would bring a certified copy of it to the bank. For some unexplained reason, he was permitted to retain this receipt.

Some time later Lange procured the defendant Slattery to indorse a note for $4000 giving him as security a set of notes of the same description as those mentioned in the deed of trust and the recorder's receipt. Upon the death of Lange, it was found that there was but one deed of trust and that both Slattery and the bank held on identical sets of notes with those referred to in the deed of trust. Slattery asked for an execution upon the trust property, but it was held that the bank was entitled to the security of the deed of trust.

The defendant contended that the plaintiff by his negligence in permitting Lange to carry away the deed of trust and in failing to get back the receipt from the recorder of deeds, put it in his power to defraud others, and the bank

6. 166 Mo. 620.

ought to bear the loss which must fall upon one of two innocent parties. It was held that the rule advanced by the defendant would not apply since there was nothing to indicate that the plaintiff had any knowledge of Lange's intention to commit a fraud and the rule is always based on knowledge. The bank had a legal right to entrust the deed of trust to Lange for the purpose of having it recorded and were not bound to anticipate that he would be dishonest.

Surely if there is such a rule of law it would have been applied as the principle of decision in this case. The court, however, expressly stated that knowledge by the party to be charged was necessary, and since knowledge is necessary, the doctrine was of no avail.

It is inconceivable that a person who has not been at fault or negligent in the slightest degree can be held liable because of the circumstances in which he may be situated. To invoke such a rule, the party to be charged must be negligent and have caused the loss through his legal wrong. The statement of the proposition is "when one of two *innocent* parties must suffer by the act of a third, the party who has enabled such third person to occasion the loss must sustain it." If both parties are *innocent* and guilty of no legal wrong, the law should permit the loss to rest where it has fallen.

The proposition is neither based on sound theory nor public policy and results in confusion, uncertainty, and injustice in the law. Considerations of fair dealing and freedom in business activities are directly opposed to it. It is almost unnecessary to say that although this proposition is often called a principle of law or a maxim, it is of neither class since it fails to appear in any authoritative statement of the law or in any of the famous books of maxims. It is said of all laws, that when the reason for the law ceases to exist, the law itself must fail. There being no possible reason or principle for this doctrine regarding innocent parties, the doctrine itself should be expunged from the law.

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