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Banks and Banking: Liability for Misrepresenting Deposits of Customer to Third Party

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BANKS AND BANKING—LIABILITY FOR MISREPRESENTING DEPOSITS OF CUSTOMERS TO THIRD PARTY

The plaintiff was a surety company whose basis for action was a loss which it contended was caused by a misrepresentation of the cashier of defendant bank. The Van Dyke Construction Company requested the plaintiff to execute bonds guaranteeing the performance of certain construction contracts and the payment of bills for labor and materials involved in the performance of those contracts. At the time Van Dyke applied for the bonds it delivered to the plaintiff a statement purporting to set forth its financial condition which indicated it had on deposit with the defendant, Plantsville Bank, a cash balance of $53,455.60. At the same time Van Dyke delivered to the plaintiff a letter on the stationery of the Plantsville Bank signed by "E. L. Sullivan, Cashier." Sullivan was then cashier of the bank and his signature was genuine. He also at that time was a stockholder of Van Dyke, owning 530 of 600 preferred shares. The letter stated that the balance of Van Dyke was $53,455.60, and that it had been granted a credit line by the bank of $150,000. The plaintiff sent a letter to the defendant bank requesting confirmation of that balance to which it received no reply. The plaintiff renewed its request two weeks later, and the bank sent a telegram confirming the balance, and subsequently a letter of which the following is the body:

> "Re: Van Dyke Construction Company
>
> The above concern has carried a substantial account with us for the past two months, balance being maintained of approximately the amount of $43,455.60 mentioned in your letter of Nov. 2."
>
> M. L. Ensle
> Asst. Cashier

The signature of "M. L. Ensle" was a forgery perpetrated by Sullivan, the cashier of the bank, and the real writer of the letter. Van Dyke did not in fact have a balance with the bank of any amount nor had the bank granted the company a credit line. Three weeks later the plaintiff executed a performance bond for Van Dyke in the sum of $200,000. Thereafter Van Dyke defaulted in the performance of the construction contracts and failed to pay certain obligations incurred for labor, services and materials. The plaintiff had to pay on the bonds a loss in the neighborhood of $50,000. The assistant manager of the plaintiff testified that it relied on the representations as to the deposit with the bank and the line of credit in furnishing the bonds, and also said that the bonds would not have been written had it not been for the representation. The application to the plaintiff by Van Dyke stated that its assets, in addition to the

non-existent deposit, were $1,700 while its liabilities at that time aggregated almost $4000. *Held:* The cashier when answering the inquiries addressed to the bank was acting within the apparent scope of his authority and the defendant bank would be liable for the cashier's misrepresentations if such misrepresentations were the proximate cause of the damage. Judgment was granted for the defendants on the ground that there was no proof of damage proximately resulting from the bank's fraud. *Standard Surety & Casualty Co. of New York v. Plantsville Nat. Bank et al,* 158 Fed. 2d, 422 (C.C.A. 2d, 1946).

The case presents two distinct questions: First, whether the bank is liable for the misrepresentation of its cashier made solely for his own benefit, and Second, was the loss proximately caused by the misrepresentation, and what proof is relevant and necessary to establish that fact.

As to the first question: The trend of modern legislation and judicial decisions has been to enlarge the employer's liability, rather than to curtail it.[1] Many of the antecedent limitations on the doctrine of *respondeat superior* are being eliminated. It was English law that to make the principal liable in a case of fraud of its agent, it was necessary to show that the act was not merely within the apparent scope of his employment but also for the *benefit* of the principal.[2] The United States Supreme Court at one time indicated a tendency toward the English doctrine in *Friedlander v. Texas Pac. Railroad Co.*[3] But at the same time, general American law did not require that the fraud be for the principal's benefit.[4] However, should the third person dealing with the agent know that the agent may be acting in his own behalf, such circumstances should put the third party on inquiry.[5]

The House of Lords overruled the Englsih doctrine that a principal is not liable for the fraud of an agent unless benefited by the fraud in 1912.[6] The principals liability for his agent's contracts has never been thus limited.[7] The House of Lords in overruling the doctrine assimilated the fraud cases to the contract cases in that the motive of the agent, which is material in creating other tort liability,

[1] Gleason v. Seaboard Airline R. Co., 278 U.S. 349 (1922).
[2] British Mut. Banking Co. v. Charnwood, 18 Q.B.D. 714 (1902); 18 Harvard Law Rev. 144 (1904).
[3] Friedlander et. al. v. Texas & Pac. R.R. Co. 130 U. S. 416 (1888).
[4] New York Railroad v. Schuyler, 34 N.Y. 30 (1865); Tome v. Parkensburg Branch R.R., 39 Md. 36 (1873).
[5] Moore v. Citizen's Nat. Bank, 111 U.S. 156 (1883); Farrington v. South Boston R. R. Co., 150 Mass. 406, 23 N.E. 109 (1890).
[6] Lloyd v. Grace, Smith & Co. A.C. 716 (1912); 26 Harvard Law Rev. 449 (1913).
[7] Hambro v. Burnand, 2 K.B. 10 (1904); North River Bank v. Ayenor, 3(Hill) N.Y. 262 (1842).

has in the fraud cases no logical bearing. The question, they said, should be resolved against the principal where the defrauded party has dealt with an agent whose acts are of the very kind he is employed to do.

The old English doctrine also has been repudiated by the United States Supreme Court, and *Friedlander v. Texas Pac. RR. Co.* distinguished and in effect overruled.[8] Justice Stone stated in the *Gleason* case:

> "The doctrine that a principal shall be held liable for the fraudulent representation of his agent made within the scope of the agent's authority is not subject to an exception exonerating the principal where the agent acts with the secret purpose to benefit only himself and without the knowledge or consent of the principal."

Again that case would appear to hold that a similar act of an agent which was merely negligent in nature, as distinguished from fraudulent, would also expose the principal to liability.

That the state courts generally hold that the principal need not benefit from the fraud of the agent to be liable is seen in many cases.[9] Therefor it seems that generally today the fraudulent acts of the agent in most courts of the country need not be for the benefit of the principal to expose the latter to liability for the results.

Next the question arises whether the act was within the apparent scope of the authority of the cashier. The cashier is the proper officer to receive deposits and to give certificates and vouchers in respect thereto.[10] Today, somewhat contrary to general opinion, banks do, in their normal course of business, gratuitously give information as to the deposits of their customers, and other credit information. The practice has become almost a necessary function, due to the extensive use of credit by the people of our country.

Perhaps in conflict with practice, the law says that Banks owe a general duty of secrecy as to customers affairs except where under legal compulsion.[11] However it has been held that where a bank gave the financial standing of a corporation to a third party, which information resulted in an injury to the corporation, the bank was not liable if the report was true and there was no malice.[12] It appears that the giving of credit information by a cashier is an act that may be within the scope of his lawful authority. An interesting case

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[8] Supra, note No. 1.
[9] Planter's Rice-Mill Co. v. Merchant's Nat'l. Bank, 78 Ga. 574, 3 S.E. 327 (1887); McCord v. Western Union, 39 Minn. 181, 39 N.W. 315 (1888); Fifth Ave. Bank v. Forty-second St. R.R. Co., 137 N.Y. 231, 33 N.E. 378 (1893).
[10] Morse, Banks & Banking (3rd Ed.) Sec. 161 (1888).
[11] Patton's Digest, Banks & Banking (1926 Ed.) Vol. 1, Sec. 565.
[12] Patton's Digest, Banks & Banking (1926 Ed.) Vol. II, Sec. 3053 (a).

however which dissents from this view somewhat held that a bank was not liable for a fraudulent representation of its cashier who was also an officer of the corporation in regard to which the information was given.[13] This case is almost in point with the principal case, but does not concur with the weight of authority.

It must further be observed that the giving of such credit information is a mere *voluntary courtesy.* The recipient thereof is in no wise entitled to it. Patton in his *Banks and Banking* has expressed this point by saying that "Banks are not in the information business".[14] Also, as a general rule, statements made by a bank officer concerning any past transactions within his scope of authority will not be regarded as binding upon the bank. They are mere courtesy. The officer owes no duty to the bank to answer interrogatories which relate only to a completed transaction. He is not employed for that purpose or held out by the bank as instructed with that duty. For such the bank is not generally liable.[15] However, the result may be different if the officer knows that the information is to be used and relied upon.[16]

When an officer of a bank makes a statement of opinion as to the condition of a company the bank is on safer ground than where he makes representations as to a customer's deposits in the bank. In the former case reliance on an opinion of an officer is hard to justify, whereas statements concerning deposits in the officer's bank are peculiarly within the knowledge of the cashier and therefor warrant reliance. Thus statements of a bank officer as to deposits where negligently[17] or fraudulently incorrect generally expose the bank to liability. On the other hand statements of officers concerning their opinion as to the financial condition of individuals or corporations are not to be relied upon, and for injuries caused by such statements banks will not as a rule be liable. Judge Clark has said in regard to such a statement, "that the cashier was not at the time acting in respect to some interest or business of the bank; his response being a mere voluntary statement, having no relation to any business transaction with the bank".[18]

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[13] Hadden et. al. v. Dooley et. al., 92 F. 274 (1899), Affirmed on Rehearing, 93 F. 728 (1899); Hoover v. Wise, 91 U.S. 308 (1874).

[14] Digest of Legal Opinions of Thom. B. Patton (1921 Ed.) Sec. 500 at page 100; Consolidated Milling Co. v. Fogo, 104 Wis. 92, 80 N.W. 103 (1899); Lemke v. First Nat. Bank of Appleton 190 Wis. 223, 208 N.W. 946 (1926).

[15] Franklin Bank v. Steward et. al. 37 Me. 519 (1853); Pres. Directors & Co. of Lime Rock Bank v. Hewett, 52 Me. 53 (1861); Morse on Banks and Banking (3rd Ed. 1888) Sec. 103 (b), at page 227; U.S. v. City Bank 21 How 356 (1858), Cashier represented corporation solvent when not: *Held*s Bank not liable, no part of cashier's business to give such information.

[16] De Swarte v. First Nat. Bank of Wauwatosa, 188 Wis. 455, 206 N.W. 887 (1925).

[17] Krause v. Busacker, 105 Wis. 350, 81 N.W. 406 (1900).

[18] First Nat. Bank of Manistee Mich. v. Marshall & Ilseley Bank of Milwaukee, 28 C.C.A. 42, 83 Fed. 725 (C.C.A. 6th. 1897).

It is interesting to note the precautions taken by banks to avoid liability for errors in information gratuitously given. In some situations courts appear to have permitted credit agencies to contract against their own negligences, even where the information is being sold and not given gratuitously as is usually the case with banks.[19]

The following is an example of a warning currently printed on the credit stationery of one bank. It seems to cover everything necessary except information concerning deposits:

> "All persons are informed that any Statement on the part of this Bank or any of its Officers as to the Responsibility or Standing of any Person, Firm or Corporation, or as to the value of any property or Securities, is a mere Matter of Opinion and given as such, and solely as a matter of Courtesy, and for which No Responsibility, in any way, is to attach to this Bank or any of its Officers."

No inquirer receiving information on such a form should successfully contend that he had a right to rely on the information, and if injured seek indemnity from the bank. However the statement does not appear to cover the possibilities which arise from information related to the deposits of customers.

As to the reliance of a third party on such information, it must be that of a man of ordinary prudence.[20] If the third party knows the agent to be interested in a favorable report, such party is not entitled to rely on the statement. But the action of the third party which causes his loss need not be induced solely by the misrepresentation of the bank, although the latter must have materially affected his action.[21] It would appear that if it is a statement concerning a deposit, the third party may rely completely upon its correctness.

The question is discussed whether it is good for business to save banks harmless for the results of such erroneous information. On the other hand it is submitted that since the bank is under no obligation to give such information, exposure to severe liability might well move banks to refrain from giving it at all. This could materially affect business since so many organizations must rely on such information to carry on their trade on a credit basis.

After determining in the principal case that the bank could be liable for the fraud of its agent because within the scope of his apparent authority, the court proceeded to the question whether the misrepresentation involved was a proximate cause of the loss.

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[19] City Nat. Bank of Birmingham v. Dun et. al., 51 Fed. 160 (1892), Reversed, 58 Fed. 174 (1893).

[20] Morse, Banks and Banking (3rd Ed., 1888) Sec. 105, Page 230.

[21] Hindman v. First Nat. Bank of Louisville, 112 F. 931 (C.C.A. 6th, 1902); Cook on Corporations, Sec. 355; Morgan v. Skiddy, 62 N.Y. 319 (1875); N.Y. Land Improvement Co. v. Chapman, 118 N.Y. 288, 23 N.E. 187 (1890).

The assistant manager of the plaintiff testified that were it not for the misrepresentation of the defendant's agent ,the plaintiff would not have executed the bond. But the court held there was no necessarily causal relation between the fraud and the plaintiff's loss, and that the proofs left the cause of the Construction Company's failure a mystery. What proof is necessary in this type of case to satisfy the requirements of proximate cause? So far as the element of causation is concerned, any loss which follows naturally upon a transaction into which the plaintiff has been induced by misrepresentation *may* be said to have been caused by it; but the same considerations which limit liability in cases of tortious harm to interests of personalty have operated in cases of business damage. If the misrepresentation was a substantial factor in bringing about the result, it will be regarded as a cause in fact. Of course it will be such a substantial factor if the result would not have occurred without it.[22]

The instant case drops into the shadowy field of fraud where a defendant is asked to "make good" a representation. The plaintiff failed here to prove that the loss would not have occurred had the representation been true. This was apparently the burden placed by the court upon the plaintiff, and since he failed to sustain it the court held the defendant would not have to make its representation good by payment of damages.

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[22] Prosser on Torts, (Hornbook, 1941), P. 321, "Causation in Fact."