

NOTES

THE THEORY OF EQUITABLE JURISDICTION OVER FRAUD.—What is the true basis of the exercise of equity jurisdiction in fraud cases when challenged by the defendant's plea of an adequate remedy at law is a much vexed problem in this country. As Pomeroy¹ pointed out, the American problem is particularly perplexing in that the conclusions reached respecting exercise of jurisdiction in the various equity tribunals, depend to a large extent upon the various courts' interpretations of the limits of their respective equity jurisdictions generally.² What part fraud cases play in the exercise of that equity jurisdiction accordingly presents a problem within a problem.

The theory under which the English equity courts exercise jurisdiction in fraud cases is the least confusing. They proceed upon the hypothesis that equity jurisdiction exists in and may be extended over every case of fraud³ (except wills), whether the primary rights of

¹2 POMEROY'S EQUITY JURISPRUDENCE (4th Ed.) sec. 910, 911, 912, 914, wherein the author exhaustively collates the English and American authorities on equity jurisprudence in fraud cases.

²"It is impossible, especially in the United States, to formulate any universal rules concerning the extent of the exercise of the equitable jurisdiction in matters of fraud, since the decisions of different courts and in different states are directly at variance with respect to its existence and extent, and since its exercise must depend to a great extent upon the circumstances of particular cases, and even upon the temperaments and opinions of individual judges." 2 POM. EQ. JUR. (4th ed.) sec. 910. See *Ada County v. Bullen Bridge Co.*, 5 Idaho 188, 36 L.R.A. 367, 47 Pac. 818.

³In *Slim v. Crowcher*, 1 De Gex. F. & J. 518, 45 Eng. Rep. 462 (1860) (an action for fraud in equity for simple pecuniary damages), Knight Bruce's separate opinion was to the effect that (p. 527): "On the merits of this case there can be no possibility of question. The only point reasonably arguable was, in which of the courts redress should be sought, and it has been said that redress should be sought in a court of law. It is true that according to modern practice a court of law would afford redress in the case by means of an action, with the assistance of a jury; but the courts of law in this country exercise jurisdiction in these cases by means of a gradual extension of their powers, and we know that that does not deprive the courts of equity of their ancient and undoubted jurisdiction which they exercised before courts of law enlarged their limits. The observation is familiar—and some of us have heard it used by Lord Eldon—that the jurisdiction not only belongs to this court, but belonged to it originally. I do not mean to say that in all cases the court will exercise the jurisdiction. It is in the power of the court to say that it will not do so in particular cases, but I am perfectly satisfied that this is a case in which the jurisdiction ought to be exercised."

Turner, L. J., said (p. 528): "If we were to grant any relief upon this appeal, we should be very much narrowing an old jurisdiction of this court, by confining it to cases in which the jurisdiction has been exercised. We should, I think, be taking the cases as the measure of the jurisdiction, instead of as the examples of that jurisdiction."

Compare the observation of Lord Elton in *Evans v. Bicknell*, 6 Ves. Jr. 174, 31 Eng. Rep. 998 (1801): "It is a very old head of equity, that if a representation is made to another person, going to deal in a matter of interest upon the faith of that representation, the former shall make that representation good, if

the parties are legal or equitable, and whether the remedy sought is equitable or simply a recovery of money, and even though courts of law have a concurrent jurisdiction of the case and can administer the same kind of relief. The English judges consider that the legal relief and procedure is never adequate in fraud cases and therefore their query is not whether the jurisdiction exists but whether it should be exercised. The celebrated case of *Slim v. Crowcher*,⁴ setting forth this policy has never been overruled in England. The early English forms of actions at law to enforce covenants and other obligations *ex contractu* did not recognize the defense of fraud, nor was there an appropriate action for the recovery of damages on account of fraud. The later growth and development of this type of relief at law did not, according to the English chancery judges, in any way curtail the original jurisdiction of equity over the whole subject matter.⁵

he knows it to be false (*Benn v. Locke*, 10 Ves. 470); and in that case and some others there appears a disposition to hold, that if there was relief to be administered in equity, there ought to be relief at law, a proposition, that seems to me excessively questionable; and I doubt whether it is not founded in pure ignorance of the constitution and doctrine of this court." *Low v. Bouverie*, 3 Ch. 82 (1891); *Colt v. Wooleston*, 2 P. Wms. 154; *Burrows v. Lock*, 10 Ves. 470; *Green v. Barrett*, 1 Sim. 45; *Blair v. Bromley*, 5 Hare 542, 556, 2 Phill. Ch. 354, 361; *Ingram v. Thorp*, 7 Hare 67; *Cridland v. Lord De Mauley*, 1 De. Gex. & S. 459; *Atkinson v. Mackreth*, L. R. 2 Eq. 570.

⁴ Cf. note 3.

⁵ See *Slim v. Crowcher*, *supra* note 3.; *Buzard v. Houston*, 119 U. S. 347, 352, 7 S. Ct. 249, 30 L. Ed. 451. To same effect *Krueger v. Armitage*, 56 N.J.Eq. 357, 44 A. 167. But note the following New Jersey rule: When the Court of Chancery entertains a suit for pecuniary recovery it applies the legal doctrine of fraud, upon the theory that it is entertaining a common law action for deceit. See *Smith v. Chadwick*, H. L. 9 App. Cases 193 (1884); *Bonded B. & L. Ass'n. v. Noll*, 111 N.J.Eq. 163, 161 A. 828, (1932). In the latter case the complainant filed a bill to foreclose two purchase money mortgages. The defendant filed a counterclaim for damages, alleging that the complainant made fraudulent misrepresentation about the property. Vice Chancellor Backes said: "Proof of deceit is not essential in equitable remedies; reformation, rescission, cancellation and the like. It is sufficient if the representations be untrue, was relied upon and injury ensued. *Eibel v. Von Fell*, 55 N.J.Eq. 70. But where the cause is legal in nature and redress may be afforded in an equity action, the rules of law are applied. Moral delinquency is essential to a recovery at law for fraud, *Cowley v. Smith*, 45 N.J.L. 380. The counterclaim in this case is entertained to avoid circuitry of action. *Shannon v. Marselis*, 1 N.J.Eq. 413. But the proof of fraud must meet the legal standard of conscious fraud, *Faulkner v. Wassmer*, 77 N.J.Eq. 537. The defendant fails on that score."

Compare *Prudential Ins. Co. v. Merritt-Chapman Corp.*, 111 N.J.Eq. 166, 162 Atl. 139 (1932), where Vice Chancellor Berry said:

"This court has inherent jurisdiction in all cases of fraud, *Eggers v. Anderson*, 63 N.J.Eq. 264; *Commercial Cas. Ins. Co. v. Southern Surety Co.*, *aff'd* 101 N.J.Eq. 738. Its jurisdiction is coextensive with that of the Court of Chancery of England as it existed at the time of the adoption of our first constitution on July 2, 1776, Pat. L. 38. In fact, the court of chancery of this state has exercised such jurisdiction since the adoption of Lord Cornbury's ordinance establishing a high court of chancery in 1705, although it is from the ordinance of Gov. Franklin adopted in 1770 that our court of chancery, as it exists today, derives

This liberal attitude towards the proper extent of the exercise of equity jurisdiction over fraud is not to be found in most American courts.⁶ The narrower limits of the general American view has resulted partly from the tendency of legislation in that direction, creating equity courts with limited powers, and partly from the construction given to the constitutional guarantee of a trial by jury. The Federal Judiciary Act⁷ restricts federal equity jurisdiction to cases where the remedy at law is not plain, adequate and complete. Most state chancery courts are similarly curtailed by constitutional and statutory enactments creating equity in the manner of the Judiciary Act.⁸

The accepted doctrine in this country is that neither exclusive jurisdiction to grant equitable relief, such as cancellation, nor concurrent jurisdiction to grant pecuniary recoveries, exists in equity in any case where the legal remedy, either affirmative or defensive, available to the injured or defrauded party is adequate, certain and complete.⁹

its jurisdiction and powers. See 19 N.J.Eq. 557; *In re* Vice Chancellors, 105 N.J.Eq. 759."

But see the following New Jersey equity practice when the remedy at law is adequate: *Knikel v. Spitz*, 74 N.J.Eq. 581, 70 Atl. 992; *Smith v. Krueger*, 71 N.J.Eq. 531, 63 Atl. 850; *Schoenfield v. Winter*, 76 N.J.Eq. 511, 74 Atl. 975 (bill to rescind a contract relating to sale of personal property maintained); *Mazzola v. Wilkie*, 72 N.J.Eq. 722, 66 Atl. 584; *L. Martin Co. v. L. Martin & Wilckes*, 75 N.J.Eq. 39, 71 Atl. 409; *Strauss v. Norris*, 77 N.J.Eq. 33, 75 Atl. 980; *Kuntz v. Tonnelle*, 80 N.J.Eq. 373.

⁶ A typical case is *Hunt v. Jones*, 203 Ala. 541, 84 So. 718 (1919) where it was said: "Fraud of itself is never, of itself, a foundation which will uphold a bill in Equity. On the contrary, fraud is in many cases, cognizable in a court of law."

See also *Learned v. Holmes*, 49 Miss. 290 (1873); *Youngblood v. Youngblood*, 54 Ala. 485 (1875); *Barkhamsted v. Case*, 5 Conn. 528 (1825); *Johnson v. Swanke*, 128 Wis. 68, 107 N.W. (1906).

See *Buzard v. Houston*, 119 U. S. 347, leading U. S. case and later case of *A. W. Feerser Inc. v. American Can Co.*, 2 F. Supp. 561, (D. Ct. Maryland 1933).

⁷ Act of Sept. 24, 1789, c. 20, sec. 16, 1 Stat. 82, Rev. St., sec. 723. Cf. also 7th amend. to U. S. Const. 1 Stat. 21, 98, "in suits at common law, where the value in controversy shall exceed twenty dollars the right of trial by jury shall be preserved." Cf. also 1 FOSTER, FEDERAL PRACTICE (6th Ed.), sec. 81.

⁸ Comprehension of state decisions as to whether equity jurisdiction is to be exercised over fraud cases in the particular jurisdiction necessarily requires a reference to the various state constitutions and statutes which create the equity side of that particular state judicial structure. In some of the states equity jurisdiction is created by statute over only a limited subject matter, in others as in the federal system only where the remedy at law is inadequate, and in another group of states equity courts exist unhampered and unrestricted. Cf. 1 POM. EQ. JUR. (4th Ed.), sec. 282 *et seq.*

⁹ *Buzzard v. Houston*, *supra*; *Johnson v. Swanku*, 128 Wis. 68, 8 Ann. Cas. 544, 5 L.R.A. (N.S.) 1048, 107 N.W. 481; *Ada County v. Bullin Bridge Co.*, 5 Idaho 188, 47 Pac. 824; *Shenehon v. Illinois L. Ins. Co.*, 110 Ill. App. 281; *Mutual L. Ins. Co. v. Blair*, 130 Fed. 971.

But cf. *Fitzmaurice v. Mosier*, 116 Ind. 363, 16 N.E. 175, the court after stating the American rule went on to say: "To exclude the equitable jurisdiction, the legal remedy must merit all the requirements of justice, and be in all

It is therefore apparent that the American view differs from the English doctrine in that the former makes inadequacy of the remedy at law the test of its exercise of jurisdiction whereas the latter considers the presence of fraud itself the controlling factor. The difference in policy is historically defensible. When the thirteen colonies severed from England they set up their own court structure and if they saw fit to define the limit of their equity jurisdiction, such was their prerogative. In setting up the federal system of courts Congress was creating a new class of tribunals with no inherited jurisdiction. So too with the judicial systems of states admitted to the union subsequently, which uniformly patterned their equity courts after those of the federal system. In 1776 some of the remedies commented upon and first afforded by the English equity courts over fraud cases were firmly established and assumed by the law courts, and it was in the law forum that most states decided that suitors should seek their relief from fraud, provided, of course, that the remedy there offered was plain, adequate, and complete. Furthermore this policy was strengthened by the desire to preserve the right of trial by jury in cases cognizable at law.¹⁰ In some of the original colonies, however, the system of equity jurisprudence existing in 1776 under the English regime was carried intact into the new state judicial structure, and the inherent jurisdiction over all fraud cases remained unimpaired. Of this group New Jersey is a notable example. The colonial concept of equity, modeled on that of the High Court of Chancery of England, was unaltered by the new state constitution, which created a Chancery Court without jurisdictional limitation.¹¹

respects, as satisfactory as the relief furnished by a court of equity." See also 5 L.R.A. (N.S.) notes at p. 1036 and 1048.

¹⁰ Cf. 7th amend. U. S. Const., *supra* note 5. "The right of a trial by jury shall remain inviolate; but the legislature may authorize the trial of civil suits, when the matter in dispute does not exceed fifty dollars, by a jury of six persons." N. J. Const., Art. 1, par. 7. I Com. Stat. 1910, iv. Similar guarantees are set forth in all state constitutions.

¹¹ "The judicial power shall be vested in a court of errors and appeals in the last resort in all causes as heretofore; a court for the trial of impeachments; a court of chancery; a prerogative court; a supreme court; circuit courts, and such inferior courts as now exist, and as may be hereafter ordained and established by law; which inferior courts the legislature may alter or abolish, as the public good shall require." N. J. Const., Art. VI, sec. 1, par. 1. I Comp. St. xcII.

Eggers v. Anderson *supra*, where after stating that the American courts have not generally upheld so broad a jurisdiction, Dixon, J., says:

"But New Jersey is distinguished from her sister states by her adherence to the standards of the mother country respecting both rights and remedies in equity, and I know of no constitutional or statutory provision or judicial decision in this state which can be regarded as withholding or withdrawing from our court of chancery any jurisdiction possessed by its English prototype. True, the jurisdiction of equity in cases of fraud remediable at law has not been much invoked, but that may be accounted for in a large degree by the less expensive, equally efficient, and in former times more speedy remedy secured in the courts of law. When resorted to, however, the jurisdiction of equity has not been doubted."

The decisions in the early fraud cases in New Jersey, therefore, unqualifiedly followed the all inclusive attitude of the English chancery courts. Jurisdiction was unhesitatingly assumed over all fraud cases. In *Krueger v. Armitage*¹² the first limitation upon this policy was stated. In that case an action was brought for purely pecuniary recoveries, and upon prompt objection *in limine*, the complainant was relegated to his adequate remedy at law. Some time later in *Eggers v. Anderson*¹³ the equity court adopted a definite rule declaring that, although its jurisdiction over the fraud field was not to be doubted, it would limit the exercise of that jurisdiction to those cases where the remedy at law was not plain, adequate, and complete. The prayer for cancellation and rescission in that case was considered by the court to seek a more complete remedy than the legal remedy, and jurisdiction was accordingly exercised. From this point on the New Jersey equity court fell into line, in theory, with most American courts. Jurisdiction was, however, in fact exercised on a far sounder basis than that followed in sister states. Suits seeking rescission and cancellation were uniformly entertained on the ground that the legal remedy was inadequate since equity alone could grant such relief; whereas the general American doctrine permitted the court to weigh the facts in each case and determine whether the exclusive equitable remedies should be granted or whether the rights of the complainant could not be adequately secured by way of an affirmative action at law for damages for deceit or by way of the defense of fraud when sued on the fraudulently induced contract.¹⁴

But the future policy of the New Jersey equity courts in fraud cases seems to be unpredictable in view of two recent decisions. The two cases, *Keuper v. Pyramid Bond & Mortgage Corp.*¹⁵ and *Downs v. Jersey Central Power & Light Co.*,¹⁶ were decided on the same day by the Court of Errors and Appeals. Both of them deal with stock subscriptions induced by fraudulent representations of the vendors. The relief sought was rescission and cancellation, and although the decisions follow the prior cases in entertaining jurisdiction the sharp division of the court indicates that the mere prayer for rescission and cancellation may not be a sufficient excuse, in the minds of some judges, for the conclusion that the remedy at law is inadequate and the resulting exercise of equitable jurisdiction. This is the attitude of the majority of American courts, and it is evident that the next fraud

¹² 58 N.J.Eq. 357 (Ch. 1899).

¹³ 63 N.J.Eq. 264 (E. & A. 1901). Compare Commercial Casualty Ins. Co. et als. v. So. Surety Co., 100 N.J.Eq. 92, *aff'd* 101 N.J.Eq. 738.

¹⁴ Compare Buzzard v. Houston, 119 U. S. 347, 7 S. Ct. 249, 30 L. Ed. 451; Macey Co. v. Macey (Mich.), 106 N.W. 722, 5 L.R.A. (N.S.) 1036 and note; Johnson v. Swanke (Wisc.), 107 N.W. 481, 5 L.R.A. (N.S.) 1048 and note.

¹⁵ 117 N.J.Eq. 110 (E. & A. 1934), an 8 to 6 decision. (This opinion by Justice Wells, reviews all the prior New Jersey cases on the fraud question.)

¹⁶ 117 N.J.Eq. 138 (E. & A. 1934), a 9 to 5 decision.

case to reach the Court of Errors and Appeals may well see New Jersey falling completely into that position.

The remedies offered by the law courts are very limited when contrasted with those available in equity.¹⁷ The English view has recognized this and contends that the legal remedy is never adequate. The New Jersey view goes almost as far except that upon prompt objection equity jurisdiction is not exercised in actions for purely pecuniary recoveries.¹⁸

Text writers agree to the general acceptance of the following fundamental principles of equity jurisdiction:¹⁹

1. Where the primary right or interest of the plaintiff is equitable only, the jurisdiction is necessarily exclusive and will always be exercised without regard to the nature of the relief; otherwise the party would be without remedy, since courts of law could not take cognizance of the case.
2. Where the primary right is legal, and the remedy sought is purely equitable, the jurisdiction is also exclusive, and always exists, but will not generally be exercised if the legal remedy which the party might obtain is adequate, complete and certain.
3. Where the primary right is legal, and the remedy is also legal, a recovery of money simply, or the possession of chattels, the jurisdiction is concurrent and only exists when the remedy which the party might obtain at law is not adequate.

The present fraud query arises, therefore, only in the second and third classifications. Equitable fraud necessarily falls within the first

¹⁷ For an analysis of the remedies available at law and equity see 1 POM. EQ. (4th Ed.) sec. 109 and 110. Black on RESCISSION AND CANCELLATION (2nd Ed.) sec. 646 and 647. Proof of fraud in equity is quite different from the standard required to make out a case at law. In equity it is sufficient if the representation be untrue, was relied upon, and injury ensued. *Eibel v. Von Fell*, 55 N.J.Eq. 670; *Commercial Casualty Ins. Co. v. So. Surety Co.*, 100 N.J.Eq. 92; *Bonded B. & L. Ass'n v. Noll*, 111 N.J.Eq. 163. Moral delinquency is essential to a recovery at law. *Cowley v. Smith*, 46 N.J.L. 380. But the injured party may not, by selecting the action that is more easily proved, obtain in equity the measure of redress that is recoverable only when the more onerous burden has been sustained in a court of law. *Faulkner v. Wassmer*, 77 N.J.Eq. 537. There is, however, one statement in the opinion of both *Commercial Casualty Co. v. So. Surety Co.*, *supra*, and *Keuper v. Pyramid Bond & Mortgage Corp.*, *supra*, which is very troublesome, i.e., that complainant is not to be put to the greater hazard of proving his case at law. Surely this cannot mean that equity will entertain fraud cases merely because of the lesser requirements demanded of the complainant in sustaining his proof. A bill filed in equity for rescission or cancellation although requiring the complainant to merely prove a material misrepresentation and damage actually seeks to place the defrauded party only in that position which he stood before the fraud was committed and the measure of damages is entirely different than that recoverable at law.

¹⁸ *Krueger v. Armitage* *supra*. Cf. other New Jersey cases cited *supra* note 3.

¹⁹ 2 POM. EQ. JUR. (4th Ed.) sec. 911.

class and is only cognizable in equity.²⁰ The problem may be further stripped by an elimination of cases falling within the third classification. Actions calling for purely pecuniary recoveries or the return of chattels without question may be disposed of adequately at law. But in those cases which are to be grouped within the second classification surely, the remedy at law can never be adequate, plain and complete. It is one thing for a court of law to permit the defense of fraud to a suit on a contract or to permit a recovery of damages on account of fraud, and another thing to cancel the obnoxious instrument and place the parties exactly as if the transaction had never taken place, as does a court of equity. In the case of writings, the evidences of the fraudulent act remain *in esse* at law whereas in a suit in equity they are nullified and destroyed. Therefore the adequacy test to which the majority of American courts adhere, although a just and fair rule of thumb, is often a much abused one. It is submitted that the remedy at law is always inadequate where rescission and cancellation are sought and that any limitation upon the jurisdiction of equity in fraud cases, beyond that declared in *Krueger v. Armitage* and the cases applying the doctrine of *Eggers v. Anderson* is a step in the wrong direction.

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LIABILITY OF BANK FOR MISAPPROPRIATION OF FUNDS BY A FIDUCIARY—DEPOSITOR.—A, a fiduciary, directs a bank to place to his personal credit checks payable to him and signed by him in his fiduciary capacity. Thereafter, A removes the funds and appropriates them to his own use. In a suit against the bank by the person in whose behalf the fiduciary was acting, should the bank be liable as a participant in the fiduciary's breach of obligation? This question, a rather troublesome one to the courts, has called forth a diversity of answers.

The transgressing fiduciary is sometimes an agent acting in behalf of a principal and is sometimes a trustee. Although some cases indicate that the ground for the decision was the distinction between these two classes of fiduciaries, we submit that there is no substantial basis for such distinction in respect to the position of the bank.¹ The agent and the trustee are equally guilty of a breach of duty if they use for their own pecuniary profit the funds of a principal or of a cestui que

²⁰ *Commercial Casualty Co. v. Southern Surety Co.*, 100 N.J.Eq. 92, *aff'd* 100 N.J.Eq. 738; *Schoenfeld v. Winter*, 76 N.J.Eq. 511.

¹ See UNIFORM FIDUCIARIES ACT, Sec. 1. The framers of the Act drew no distinction between the types of fiduciaries. Sec. 1 says: "Fiduciary" includes a trustee under any trust, express, 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 other person, trust, or estate."