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AGENCY AND ESCROW

ROGER K. GARRISON

There are myriad instances in the law where courts or legislatures of various states have given precise definition to a certain legal status. Such words as "trustee," "guardian," and "mortgagor" have come to have fixed meanings and definite legal incidents attached to them. Not so fortunate, however, has been the term "escrow holder," or sometimes "escrowee." While courts are generally in accord as to what circumstances will create an escrow transaction, statements of the precise legal status of the escrow holder are noteworthy for their discord rather than their harmony.

As yet no court has seen fit to regard the escrow holder as *sui generis*. Courts persist in finding the legal incidents of the escrow holder's status in terms of other concepts which have already been delineated. This process ultimately leads to what has been called a "jurisprudence of conceptions," a phenomenon which has been assailed as unsound.¹ It is the purpose of this article to examine the plight of the escrow holder with particular reference to a problem which has recently been before the Washington Supreme Court no less than three times, namely: upon whom does the loss fall when an escrow holder becomes insolvent or absconds with the funds of an escrow transaction?

The first Washington case was *Lieb v. Webster*.² In that case the escrow holder had the duty of procuring the title insurance on the property sold, and this duty was made a condition precedent to the vendor's right to receive the money which had been paid in by the vendee. There was probably a pure agency situation as to the title insurance, for it is usually purchased by the vendor as his proof of a marketable title. The title insurance had not been procured at the time the escrow holder absconded with the funds of the transaction. The court held that since it was clear that when the money was deposited by the vendee, the escrow holder held it as *agent* for the vendee and there was no evidence that this relation changed, the loss of the funds must fall on the vendee.

It appeared from the facts of the case that the escrow instructions of the vendor were met by the vendee, and the vendee had paid the money

¹ Pound, *The Theory of Judicial Decision*, 36 HARV. L. REV. 802, 817 (1923).

² 30 Wn.(2d) 43, 190 P.(2d) 701 (1948).

over to the escrow holder in compliance with them "for the account of the vendor." An argument could be made that the escrow holder held the funds for the vendor at the time they were paid in. No previous decision compelled the court to agree that the funds were held at the time of deposit for the person who deposited them rather than for the person to whom they were to be delivered. However, the fact that the court chose the former position in preference to the latter, permits a rationalization of the case on a theory other than "agency."

This alternative would be in terms of "ownership of the money." The reasoning is that as a general proposition, when property is lost, the loss must be borne by the person who owned it. The money in the *Lieb* case was the property of the buyer at the time he paid it over to the escrow holder, and it did not become the property of the seller until he, the seller, was entitled to receive it. He was not entitled to receive it until the conditions of the escrow which were placed on the disbursement of the money by the buyer were either met or excused. Therefore, prior to the performance of the conditions imposed by the buyer, the buyer bears the loss of his own money, and subsequent to this time the seller bears the loss of his own money. The argument is strong that after the performance of all the conditions the seller owns the money, but it is not so clear that the buyer owns it prior to the performance of the conditions, for he has lost some of the usual incidents of ownership, *e.g.*, right to possession and control. He has only the right to obtain the performance of the seller and the possibility that the seller may default and permit the buyer to demand return of the money. To find the buyer the owner of the money after he has paid it in, one must argue negatively, *i.e.*, he *did* own it; no one else has become the owner; therefore he must *still* own it. This argument must of necessity depend upon the dubious validity of the proposition that "ownership of the money" must be in one party or the other and not in both concurrently.

The possibility must be always kept in mind that the use of agency language does not necessarily mean a philosophic commitment to agency principles. But the fact remains that in the *Lieb* case and its sequels the court used agency language and it cannot be safely asserted that they did not mean what they said. If the commitment to agency is only verbal, there is the danger that this language may in the future lead the court to apply agency principles, which as will be seen are incompatible with the operation of the escrow device. It is interesting to note that the rule used in the *Lieb* case to place the loss was actually

an agreement of the parties as to what the law on that point was. The court cites no authority and gives no affirmative indication that it believes the rule to be correct.

The later case of *Angell v. Ingram*³ involved a set of facts strikingly similar to the *Lieb* case. The only way the appellant could prevail was either to distinguish the *Lieb* case on its facts or attack its major premise, the rule of law used. Counsel chose to do the former and failed, the court saying at the outset of its opinion, "The parties agree that the rule laid down in *Lieb v. Webster* is the one that must be applied." This statement is ambiguous since it is not clear whether it means that the court "laid down" the rule in the previous case, or that the parties did not dispute the rule of the *Lieb* case, and so sheds little, if any, light on the court's own position as to the rule of law used.

The possibility that the court would repudiate its previous use of agency language and adopt some theory other than that of the principal's liability for the acts of his agent was definitely settled by *Lechner v. Halling*⁴ when it was said by the court, "As the trial court recognized, the rule to be applied in this type of case was laid down by this court in *Lieb v. Webster* and reiterated in *Angell v. Ingram*." Thus it appears that the court decided the third case on the basis of the first two, the second on the basis of the first, and the first on the agreement of counsel that the correct rule is stated in *American Jurisprudence*,⁵ which fact appears from the appellate briefs of both parties and the statement in the appellant's brief that "the rule of law is not disputed by the parties to this action."⁶

In the recent case of *Schrock v. Gillingham*⁷ the court made use of the *Lieb* and *Angell* cases to support a holding that an embezzling real estate agent brought the loss down on the person for whom he was acting. The case is not strictly germane to this discussion in that there was no escrow agreement and the embezzler was not an escrow holder, but a true agent. It is interesting however, in that it clearly demon-

³ 135 Wash. Dec. 551, 213 P.(2d) 944 (1950).

⁴ 135 Wash. Dec. 845, 216 P.(2d) 179 (1950).

⁵ 19 AM. JUR., *Escrows* § 11. A portion of this section was quoted by counsel as follows: "When an instrument has been delivered to a depository as a writing or escrow of the grantor, it does not become a deed, and no legal title or estate passes until the condition has been performed or the event has happened upon which it is to be delivered to the grantee. . . . The same rule is applied to the deposit of moneys with an escrow agent in determining upon whom the loss falls when the escrow agent fails . . . the courts holding that the title to the money depends upon whether the condition under which the money had been deposited had been performed or not."

⁶ Appellant's brief p. 12.

⁷ 136 Wash. Dec. 386, 219 P.(2d) 92 (1950).

strates that the court sees no difficulty in applying the same rule to both an escrow transaction and a true agency problem.

The cases discussed above reveal that whenever the loss was placed on one party, it was so placed with reference to whether or not the *conditions* of the escrow agreement had been complied with. The question of what conditions were important received an answer in the *Lechner* case where it was said that in order to solve the problem of the identity of the principal at the time of the loss "it is first necessary to determine whether all the conditions which the vendee attached to the disbursement of the funds had been complied with prior to the delivery of the deed and other instruments to them."⁸ Restated, the rule is: the vendor does not become the principal as to the money until such time as all the conditions precedent to his right to receive the money have been fulfilled. At first blush this seems to be inconsistent with the holding in the *Lieb* case, for there all the things to be done by the vendor himself had been done. But a closer analysis shows that at the time the escrow holder absconded there was still unperformed a condition precedent to the vendor's right to receive the money, to wit: the procurement of title insurance by the escrow holder as agent of the vendor. Although the court has not as yet discussed the merits of the rule, the fact that it was essential to the holding in four cases makes it almost certain that such is now the law of the state of Washington.

A further proposition bearing on the announced rule is that the fact that there are conditions precedent to the vendee's right to receive the documents of title seemingly will not prevent the vendor from becoming entitled to all or part of the funds deposited with the escrow holder.⁹ Further, it may be well to point out that under the announced rule, it is possible for the vendor to become entitled to some of the money, but not all of it, and thus cause each party to the transaction to bear a part of the loss.¹⁰

It is essential to the utility of the rule that the point in time at which the funds were lost be determined. The rule would seemingly be impossible to apply if this important fact were unsettled.¹¹ The factors

⁸ *Lechner v. Halling*, 135 Wash. Dec. 845, 851, 216 P. (2d) 179, 184 (1950).

⁹ This proposition is implicit in the rule, in that the court is seemingly concerned *only* with conditions precedent to the vendor's right to receive the money, and not the vendee's right to receive the performance of the vendor.

¹⁰ *Schrock v. Gillingham*, 136 Wash. Dec. 386, 219 P. (2d) 92 (1950). This must be qualified to the extent that the *Schrock* case did not involve escrows, although it was treated as though it did.

¹¹ An extremely complex practical problem could arise in connection with this aspect of the rule. For example, if an escrow holder was handling several transactions at once (which is a common situation) and embezzlements took place over a period of

involved in the solution to this collateral problem are, however, outside the scope of this article. It is sufficient to say that in answer to the basic inquiry of who bears the loss when the funds of an escrow transaction are lost, the Washington court has so far said: (1) the person for whom the escrow holder is holding the funds as agent bears the loss; (2) which party is the principal as to the funds depends upon whether or not the conditions of the escrow transaction have been met at the time of the loss; (3) the important conditions are those precedent to the vendor's right to receive the funds.

The Washington Supreme Court in using agency language in dealing with the escrow holder, has fallen into step with a majority of courts which have dealt with the problem. This, however, is not conclusive proof that the application of a rule of agency law in a situation of this sort is in all respects the most equitable mode of solution or that the rule is easy to apply. The vice of the agency approach lies in the remote and subtle distinctions which abound in the law of agency generally and which have little appeal for either the lawyer or the layman. Especially is this true when large losses are fastened on one of two equally innocent parties. The inconsistency of using agency rules, where it is convenient and abandoning them when it is not, gives some force to the argument that they should not be used at all in escrow transactions.¹²

In discussions of theory it is often of value to see what the text writers have to say. Walsh says that when a deed is delivered to an escrow holder, the escrow holder holds it at that time for the person to whom it is to be delivered.¹³ This is precisely the reverse of the position taken by the Washington court and courts generally. Tiffany criticizes the whole structure of escrow transactions, pointing out that the purposes of the escrow transaction is to effect a conditional delivery of a deed; that delivery is merely an expression by word or act that the instrument have legal operation; that this is a matter of intent, and the emphasis attached to the physical delivery of an instrument of

time, during which lesser sums were replaced and later removed, etc., it would be virtually impossible to determine with any degree of accuracy how much of a given fund was embezzled at a given time.

¹² An escrow holder has been held to be such an agent that his knowledge is imputed to the grantor and grantee. *Earley v. Owens*, 109 Cal. App. 489, 293 Pac. 136 (1930); *Ryder v. Young*, 9 Cal. App. (2d) 545, 50 P.(2d) 495 (1935). But it has been also held that he is not enough of an agent that he can accept a check, admittedly good, in lieu of the cash required by the contract. *Thornhill v. Oleson*, 31 N.D. 81, 153 N.W. 442 (1915). For a vivid illustration of the difficulty that can arise when knowledge is imputed see *Nelson v. Ashton-Jenkins Co.*, 66 Utah 351, 242 Pac. 408 (1925); *Smith v. Brown*, 1 Cal. App. (2d) 492, 36 P.(2d) 1081 (1934).

¹³ WALSH, COMMENTARIES ON THE LAW OF REAL PROPERTY § 214, p. 471 (1947).

conveyance is a "relic of primitive formalism."¹⁴ Thompson says that the escrow holder is the agent of both parties individually¹⁵ but goes to some length to distinguish between a delivery to an agent of the grantor and a delivery to an escrow agent of the grantor.¹⁶

It is submitted that agency rules as to the disposition of the loss are only a makeshift—a mere device to settle a difficult problem. No one has yet attempted to be consistent in the use of agency theory in this area, and it could not be done. For example, if the grantor delivers an instrument of conveyance in escrow he may not legally demand it back within the time limit of the escrow,¹⁷ and if the grantor dies, the escrow holder's "agency" is not terminated,¹⁸ which demonstrates to some extent at least that the escrowee is not an agent in the usual meaning of the word. Further, there could never be an escrow if agency rules were used normally, for if the grantor is the principal when he deposits the instrument of conveyance he could demand it be returned to him thus destroying the "delivery beyond the control of the grantor" which is a requisite of a true escrow. If the escrow holder is the agent of the grantee, there is absolute delivery and the grantee takes free of the conditions by virtue of the rule of delivery of a deed to an agent of the grantee.¹⁹

In a case which has been generally overlooked, it was said by the Kansas court:²⁰

A certain resemblance between the office of the agent and the office of depositary of an escrow lead us to speak of a depositary as an agent. We immediately get into trouble, however, when we speak of a depositary as the agent of the vendor to receive the purchase money and deliver the deed. . . . Following the line of least resistance, we hasten to say that the depositary is not the agent of the vendor merely, but is the agent of both parties. When, however, we undertake to found arguments upon and to draw conclusions from this application of the name "agent," we immediately get into trouble. . . . The result is a depositary is always something more or something less than an ordinary agent, and accuracy permits us to say no more than the depositary is an intermediary. . . .

. . . When the depositary steps outside the sphere of authority created

¹⁴ 4 TIFFANY, THE LAW OF REAL PROPERTY § 1049 (3rd ed., Jones, 1939).

¹⁵ 7 THOMPSON, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY § 4196 (Perm. ed., 1940).

¹⁶ 7 *Id.* § 4197.

¹⁷ WALSH, *op. cit. supra* note 13, § 214 n. 7.

¹⁸ *Id.*, § 214 n. 9.

¹⁹ This rule as usually stated will be found in 7 THOMPSON, *op. cit. supra* note 15, § 4197.

²⁰ *Smith v. Griffith*, 105 Kan. 357, 184 Pac. 725 (1919); see *Nickell v. Reser*, 143 Kan. 831, 57 P.(2d) 101 (1936).

by the escrow agreement . . . *he does not act as the agent of the party to the escrow agreement whose rights are prejudiced by his conduct.* Since his powers are defined by the escrow agreement there can be no misconception of them. Vendor and vendee deal with him in respect to the escrow at their peril. . . . If he be guilty of a breach of duty in delivering, without payment of the purchase money . . . he is not the agent of the vendor in making the misdelivery. (*Italics supplied.*)

This should be sufficient to demonstrate that a thoroughgoing application of agency law is incompatible with the recognized attributes of the escrow holder. Some courts have recognized this difficulty with the agency theory and have sought to solve it by placing a tag on the escrow holder and making him "like" some other legal animal. Thus the escrow holder has been called a "trustee,"²¹ but this can be dismissed summarily, as no title ever vests in him although there are situations where the escrow holder *could* be a trustee should the grantor intend that he be one.²² The United States Supreme Court has called the escrow holder a stakeholder.²³ This terminology has been criticized because it connotes a gambling transaction.²⁴ Whether or not this criticism has merit depends upon one's personal devotion to the escrow device. A more practical shortcoming would seem to be the fact that the two terms are nearly synonymous and neither has been defined separately. Therefore, to define one in terms of the other is meaningless. Seavey has suggested that the escrow holder might be considered as being in the same position as an agent who has a power coupled with an interest.²⁵

In view of the varying terminology which has been used from time to time which has as its purpose an avoidance of the problem or is beset with the greater evil of self inconsistency, the most proper solution would seem to be to treat the escrowee as *sui generis* and have done with attempts to define the relationship in terms already applied to dissimilar situations. There is no conceptual difficulty in this approach; it is only a matter of recognizing the escrow holder as an individual whose status is unique in the law. It is the opinion of the writer that the

²¹ *Farago v. Burke*, 262 N.Y. 229, 186 N.E. 683 (1933); *Feisthamel v. Cambell*, 55 Cal. App. 774, 205 Pac. 25 (1921); *Siebel v. Higham*, 216 Mo. 121, 115 S.W. 987 (1908). In *Squire v. Branciforti*, 131 Ohio St. 344, 2 N.E. (2d) 878 (1936), a bank which received funds as escrow holder and mingled them with other funds was held to be a trustee of the money so that the parties to the escrow contract were entitled to a preference when the bank closed its doors.

²² RESTATEMENT, TRUSTS § 32(c) (1935).

²³ *Citizens National Bank v. Davisson*, 229 U.S. 212 (1913), cited as authoritative in *Lyons v. Liberty National Bank*, 65 F.(2d) 837 (D.C. Cir. 1933).

²⁴ E. L. FARMER, ESCROWS 10 (1931).

²⁵ SEAVEY, STUDIES IN AGENCY 167 (1949).

general rules of agency are so foreign to the practicalities of the escrow device that they should not be used. *A fortiori*, the one aspect of agency law that has been used when the escrow holder absconds with the funds of an escrow transaction should also be abandoned. The "ownership of the money" theory previously discussed as an alternative rationalization in the *Lieb* case brings one out with the same practical result as an agency theory, so long as it is insisted that the total ownership be in one party or the other. However, if this latter element of the argument is abandoned, and co-ownership of the funds permitted, the practical effect of an escrow holder absconding before the conditions of the escrow had been completely performed would be to split the loss between the parties to the transaction. It is submitted that this result may be the desirable one, if the abstract justice of the situation is regarded, and the legal niceties overlooked.

In the typical case there is little, if any, fault attributable to either party alone, and neither should bear the whole loss. California, which founded, in the leading case of *Hilderbrand v. Beck*,²⁶ the rule used by the Washington court, has voluminous *dicta* to the effect that at least prior to the time the conditions of the escrow have been met the escrow holder is the agent for both parties.²⁷ One implication from those cases is that the loss would be split when a defalcation of the escrow holder occurred at this stage, as it did in both the *Lieb* and *Angell* cases.²⁸ The cases, however, do not bear this out.

It does not seem inaccurate to say that both parties to an escrow agreement have an interest in it as a whole, for each does have an interest that will be protected in equity,²⁹ and both are anxious that it be carried through in the usual case, or they would not have contracted in the first instance. Why then should one party bear the whole loss when both are in complete good faith and the loss arises through the

²⁶ 196 Cal. 141, 236 Pac. 301 (1925). See Note, 39 A.L.R. 1080 to the effect that the *Hilderbrand* case is the first one on the exact point of who bears the loss when an escrow agent absconds. This case is also the only square holding supporting the rule set forth by 19 AM. JUR. *Escrows* § 11, relied on by the Washington court in the *Lieb* case although not cited. See note 5, *supra*. The rule as stated in 30 C.J.S., *Escrows* § 9, n. 82 cites but one case not founded on the *Hilderbrand* case which came to the same conclusion independently, namely, *Foster v. Elswick*, 176 Ark. 974, 4 S.W. (2d) 946 (1928); accord, *Crum v. City of Los Angeles*, 110 Cal. App. 508, 294 Pac. 430 (1930).

²⁷ *Blackburn v. McCoy*, 1 Cal. App. (2d) 648, 37 P.(2d) 153 (1934); *New Port Bay Dredging Co. v. Helm*, 120 Cal. App. 127, 7 P.(2d) 1039 (1932); *First National Bank v. Caldwell*, 84 Cal. App. 438, 258 Pac. 411 (1927); *Shreeves v. Pearson*, 194 Cal. 699, 230 Pac. 448 (1924); *Feisthamel v. Campbell*, 55 Cal. App. 774, 205 Pac. 25 (1921).

²⁸ BURBY, HANDBOOK ON THE LAW OF REAL PROPERTY 402 (1943).

²⁹ *Feisthamel v. Campbell*, 55 Cal. App. 774, 205 Pac. 25 (1921); WALSH, *op. cit. supra* note 13 § 214.

fault of a third person who by definition must be a stranger to the parties?

No harm and much good could come from a re-examination of the escrow holder's status when the opportunity next presents itself to the Washington court. No principle of justice requires that a heavy loss be cast upon one of two equally innocent parties. It is possible that legislative action could in part cure the hardship that results when an escrowee absconds with the funds of an escrow transaction. Nearly every one who has access to public funds is bonded, often in very large amounts. This prudent practice extends from bank presidents (statutory)³⁰ down the scale to sales clerks (good sense). The Washington court has endorsed such measures³¹ and the California Code requires it,³² although the amount seems inadequate.

³⁰ REM. REV. STAT. § 3239 [P.P.C. § 309-35].

³¹ *Lieb v. Webster*, 30 Wn.(2d) 43, 50, 190 P.(2d) 701, 705 (1948).

³² Cal. Laws 1947, c. 921 [Deering's California Code, Vol. I § 2365].