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Wrongful Delivery of Deed in Escrow

W. Lewis Roberts
University of Kentucky

WRONGFUL DELIVERY OF DEED IN ESCROW

The Kentucky Court of Appeals in *Vaughan* v. *Vaughan*[1] has defined an "escrow" as "a writing delivered to a third party to hold until the happening of some event, as until it is signed by another party, consideration paid, or a suit be dismissed, and until the event happens or the condition be performed, it can have no effect." As the court pointed out, the term originally applied to instruments for the conveyance of land.

Such a delivery of a deed to a third party to be later delivered by him to the grantee upon the latter's compliance with the condition named, has given rise to some very interesting questions. One of the most interesting is who should bear the loss when the depository wrongfully delivers the deed to the grantee before the condition has been fulfilled? The determination of this question depends upon when there is an effective delivery of the deed, whether the deed becomes effective on the delivery by the grantor to the depository or on the delivery by the depository to the grantee or upon the performance of the condition by the grantee.

It was early laid down in Shepard's Touchstone[2] that "when the conditions are performed and the deed is delivered over, the deed shall take as much effect as if delivered immediately to the party to whom the deed is made, and no act of God or man, can hinder this effect, if the party that doth make it be not at the time of making thereof disabled to make it."

The difficulty, however, with making the deed effective from the second delivery of the performance of the condition was that it did not work justice in cases where the rights of third parties, as creditors, for instance, intervened between the first and second deliveries. To take care of such cases the doctrine of relation back was resorted to. In speaking of this doctrine of relation back, we find the author of the Touchstone[3] saying: "Where deeds have a kind of double delivery, as in case of a delivery as an escrow, there they shall take effect from, and have relation to, the time of the first delivery, or not, *ut res valeat*: for if the relation may hurt, and for some cause make void, (as in some cases it may) there it shall not relate; but if the relation

[1]161 Ky. 401, 170 S. W. 891 (1914).
[2]Chap. 4, p. 59.
[3]P. 72.

may help it, as in case a *feme sole* delivers a deed as an escrow, and before the second delivery she is married or dieth, in this case, if there were not a relation, the deed would be void and therefore in this case it shall relate."

Also in Perryman's case[4] it was said, "If a man delivers a writing as an escrow, and afterwards the obligor or obligee dies, and afterwards the condition is performed, the deed is good, for there was, *traditio inchoate,* in the life-time of the parties, *sed postea consummata existens* by the performance of the condition, take its effect by force of the first delivery."

Thus the law was early established that a deed in escrow took effect from the second delivery[5] but that in exceptional cases under the doctrine of relating back the deed would be given effect from the time of the first delivery in order to do justice in the particular case, or to carry out the intention of the parties.[6]

Since this doctrine of relation back is a fiction of law invoked to do justice, the question naturally arises as to whether it should be invoked against an innocent purchaser. If the courts in these cases of escrows have, with one or two exceptions, been working out the legal rights of the parties in the same way that equity courts would have worked them out as equitable rights, as has been suggested by Professor Bigelow,[7] then the innocent purchaser for value should be protected in all cases where equity would protect him. Of course, the most common case is where the depositary wrongfully delivers the deed to the grantee before the condition is performed and the grantee deeds the land to an innocent purchaser for value. While the overwhelming weight of authority is that such an unauthorized delivery or fraudulent procurement of delivery does not pass title so that the *bona fide* purchaser from the grantee should be protected, there are a few courts that have said the maxim that where one of two innocent persons must suffer a loss, the one who has put it in the power of another to cause that loss, should bear that loss, should apply; that the grantor, since he selected the depositary, should bear any loss that comes through the depositary's default. In *Blight v. Schenck,*[8] the Pennsylvania court took this

[4] 5 Coke, 84.
[5] *Cook's Adm'r* v. *Hendricks,* 20 Ky. (4 T. B. Monroe) 500 (1827).
[6] *Craddock* v. *Barnes,* 142 N. C. 89, 54 S. E. 1003 (1896).
[7] Conditional Deliveries of Deeds of Land, 26 Harv. L. R. 565, 575.
[8] 10 Pa. St. 285, 57 Am. Dec., 478.

position, saying that the agent had power to deliver the deed and if he delivered it contrary to his instructions, he was answerable to his principal and it was therefore reasonable that the latter, and not the innocent purchaser, should bear the loss.

Advocates of this view urge the analogy of the law of negotiable instruments and point out that the weight of authority is to the effect that if a promissory note is deposited in escrow with a third person and its delivery is procured by the payee from the depositary without the maker's knowledge or consent and without the performance of the condition, the innocent purchaser from the payee may hold the maker;[9] and this is the rule under the Negotiable Instruments Law.[10] The Negotiable Instruments Law, in fact, provides that the validity of the delivery in such cases shall be conclusively presumed, and it is urged that there is as much reason from the point of view of public policy for protecting the *bona-fide* purchaser in one case as in the other. While in the case of negotiable instruments there is the policy of making bills and notes pass from hand to hand like money, there is in the case of conveyances of land the policy of making public records of such conveyances conclusive as to what appears on such records. For these reasons those who would protect the innocent purchaser from the grantee who has wrongfully procured a delivery of the deed from the depositary, would raise a conclusive presumption of a valid delivery against the grantor in favor of the *bona fide* purchaser or by law impose an agency on the depositary to pass title in such cases.

To the writer, such a result seems not to be in keeping with the fundamental nature of a delivery in escrow. While the term "escrow" originally meant a scrowl or writing and that the instrument on its first delivery was nothing more nor less than a mere scrowl or writing, it was early pointed out that such a delivery had a greater legal significance than the mere delivery of a piece of paper.[11] In 1591, the court of King's Bench in the famous case of Butler and Baker[12] said: "To some intent, the second delivery hath relation to the first delivery, and to some

[9]Norton, on Bills and Notes (4th Ed.), p. 99.
[10]Section 16 (3rd sentence).
[11]Blackstone's Commentaries, Book II, p. 307.

not, and yet in truth, the second delivery hath all its force by the first delivery; and the second is but an execution and consummation of the first; . . . ."

Since the second delivery has all its force by the first, it has been suggested that the first delivery really leaves a fee in the grantor subject to be defeated by the grantee's performing the condition named therein or the happening of the event specified. This suggestion as to the real nature of a deed in escrow has received some recognition by judges and legal writers in recent years. It was pointed out by Judge Walker of the North Carolina court in the case of *Craddock* v. *Barnes;*[13] by a note writer of the Harvard Law Review in 1904;[14] and by Professor Ballantine in a very learned article on the nature of escrows published in the Illinois Law Bulletin.[15]

To quote from the opinion in the North Carolina case: "Some courts hold that an escrow does not take effect as a fully executed deed until there has been a rightful delivery to the grantee; but the logical position approved in a number of authorities is that it is effective as a deed when the grantor relinquishes the possession and control of it by delivery to the depositary, and it passes the title to the grantee when the condition is fully performed, without the necessity of a second delivery by the depositary, and it may by a fiction of the law, have relation back to the date of its original execution, or deposit, when necessary for the purpose of doing justice or of effectuating the intention of the parties."[16]

The Harvard note writer, after considering some jurisdictions that allow the innocent purchaser for value from the grantor to prevail over the grantee of the escrow on the ground that the doctrine of relation is a fiction invoked to do justice and therefore should not apply against such a *bona fide* purchaser, says: "Other jurisdictions do not allow an innocent purchaser to defeat the grantee in escrow. These jurisdictions hold that

[13]142 N. C. 89, 54 S. E. 1003 (1906).
[14]18 Harvard L. Rev. 138.
[15]3 Illinois L. Bulletin, 1, 12. (1920).
[16]The court in its last sentence of the passage quoted is stating the general doctrine of relation back. This seems inconsistent with the position that the instrument is a deed forthwith on the delivery to the depositary. If the deed is effective on the first delivery when the grantor puts it out of his control, it is useless to talk about relation back.

after the deed is placed in escrow the grantor no longer has full legal title. The grant in escrow puts the land out of his power and makes it possible for the grantee to get something analogous to specific performance at law. All that the grantor has is a title subject to a defeasance, and a title subject to a defeasance is all that a purchaser from him, whether *mala fide* or *bona fide*, can buy.

Professor Ballantine expresses the idea in a clearer and, perhaps, more forceful way. He says: "While it is true that deposit in escrow does not divest the grantor of his 'title' it does create a change in the legal relations between the grantor and the grantee with reference to the land. If B does nothing, title remains in A. If B performs the condition, title passes to him. Where the condition is a future voluntary act of the grantee, the deed creates an irrevocable power in the grantee to draw the title out of the grantor. Where the condition is any other event, the deed creates an irrevocable conditional interest in the grantee. An escrow prior to the performance of the condition is therefore not a mere paper like a will before the death of the testator. It changes legal relations. It is not a mere draft of a deed or an executory contract to convey, but is a deed presently with a definite legal operation. Every act necessary to a complete operative deed must be done by the grantor, who delivers the escrow deed to a third person subject only to a condition precedent suspending transfer of the complete and unconditional property interest. A conditional delivery is as final and binding an expression of intent as an absolute delivery."[17]

The position taken by these authorities seems to the writer to be sound. The instrument when delivered to the depositary in escrow is an effective deed forthwith and creates and changes legal interests in the land. The grantor who before the delivery had a fee simple estate in the land, after delivery, has a defeasible fee simple or holds his estate, as Professor Ballantine points out, subject to an executory limitation.[18] It is beyond the grantor's power to prevent his estate from divesting upon the happening of the event or fulfillment of the condition that is to create an estate in the grantee. An irrevocable power is created in the grantee as suggested in the passage quoted above, whereby

[17]Illinois Law Bulletin 1, 10.
[18]Ibid., p. 13.

he can take the title out of the grantor and put it into himself. The New York court early referred to the grantee's interest as "a quasi-creation of an estate subject to be defeated by the failure to perform the stipulated condition."[19]

The view that the first delivery of a deed in escrow is effective and leaves a defeasible fee in the grantor, seems to be more in accord with the results reached in the greater number of cases and to harmonize the decisions much better than any other theory that has been suggested. The instances noted by the King's Bench in the early case of Butler and Baker[20] as exceptions are consistent with it. Where the grantor is a *feme sole* at the time of the first delivery, her marriage before the time of the second delivery does not affect the rights of the grantee, or if the grantor dies before the second delivery the grantee's right is not thereby cut off. Also consider the converse of these cases, where the grantor was under disability, such as infancy, insanity or coverture, at the time of the first delivery, but becomes of age, or sane or discovert before the time of the second delivery. In none of these cases will a delivery after the disability is removed make the deed effective. It was inoperative at the time of the first delivery and therefore did not create a defeasible fee in the grantee, and consequently a performance of the act called for on the part of the grantee would not cut short the grantor's fee.

The grantor remains liable for the taxes until his estate is terminated by the performance of the condition as in the case of any other estate subject to an executory limitation.[21] The grantor, on the other hand, is entitled to the rents and profits until the condition is performed[22] but where the parties have stipulated that the grantee shall pay interest from the date of the contract, he is entitled to the rents and profits from that date.[23]

Let us consider also the case of the purchaser from the grantor after he has deposited a deed of the same land in escrow. Just as in the case of a conveyance by a vendor who has made a binding contract for the sale of land the transferee takes sub-

[19] *Hunter* v. *Hunter*, 17 Barb. (N. Y.) 25.
[20] 3 Coke 25a, 35b.
[21] *Mohr* v. *Joslin*, 162 Ia. 34, 142 N. W. 981; *McMurtrey* v. *Bridges*, 41 Okla. 264, 137 Pac. 721.
[22] Tiffany, Real Property (2nd Ed.) (1781.)
[23] *Scott* v. *Solan*, 72 Kan. 545, 84 Pac. 117.

ject to the rights of the grantee of the escrow deed provided he takes with notice. He gets no more than his transferor has, a defeasible estate.[24] That the *bona fide* purchaser for value should be protected is consistent with our registration laws and, therefore, not inconsistent with the view of the nature of an escrow suggested by the authorities quoted. The position of the creditor of the grantor who attaches the land conveyed in the escrow deed is no better than that of the purchaser with notice as was held in the case of *Hall* v. *Harris*.[25] In a few jurisdictions such an attaching creditor is regarded as a *bona fide* purchaser for value and is given priority over the grantee of the escrow deed.[26] The position of the heir, the donee, and the devisee of the grantor is like that of the purchaser with notice.[27] Since the grantor has a defeasible fee only, his heir, his donee, or his devisee should take no greater estate.

Not an uncommon case to arise where there is a delivery to a third party to hold until the happening of some event, is where the delivery is conditioned upon the grantor's own death. A few courts have solved the difficulty in this case by holding that such instruments are testamentary and ineffective unless they conform to the requirements of the law as to wills,[28] but the great majority of courts hold such deeds valid. Some have regarded the deed as immediately vesting the fee in the grantee subject to a life estate in the grantor.[29] Others support the conveyance as creating an estate *in futuro* in the grantee with a resulting fee in the grantor, subject to a limitation in the grantee named conditioned upon the death of the grantor.[30] Those courts that sustain such deeds without distinguishing them from the cases where the vesting of the estate in the grantee depends upon some act of the grantee himself, lay stress upon the doctrine of relating back to the first delivery. The decisions that uphold these deeds that are to take effect upon the death of the grantor are undoubtedly correct but the ground for their correctness, it is

[24] *Wilkins* v. *Somerville*, 80 Vt. 48, 66 Atl. 893; Tiffany Real Prop. (2nd Ed.) (1780).

[25] 5 Ired. Eq. (N. C.) 303, (1848).

[26] Tiffany, Real Property (2nd Ed.), p. 1780.

[27] *Cook's Adm'r* v. *Hendricks*, 4 T. B. Mon. (Ky.) 500; *Lindley* v. *Groff*, 37 Minn. 338, 34 N. W. 26.

[28] *Turner* v. *Scott*, 51 Pa. St. 126.

[29] *Kirby* v. *Hulette*, 174 Ky. 257, 192 S. W. 63.

[30] Note and cases cited, 30 Harv. L. Rev. 508.

submitted, is that the deed is operative when executed and creates a future limitation. The courts that rest their decision in such cases upon the creation of a present fee in the grantee subject to a life estate in the grantor are at least changing the language of the instrument.

When we consider the effect of a delivery of a deed in escrow from the point of view of the grantee, we find that upon the performance of the condition title vests in the grantee without the depositary's handing over the deed,[31] and the grantee is then entitled to the possession of the deed as evidence of his title and may proceed against the depositary at law upon his refusal to give it up.[32] This, too, is consistent with the idea that first delivery creates a defeasible estate in the grantor.

Turning now to the question in regard to the effect of a deed in escrow in which we are more especially interested, that is where there is a wrongful delivery by the depositary we find that the view taken as to the nature of a delivery in escrow is consistent with the holding of the majority of courts on this point. The weight of authoritiy follows the rule laid down in the leading case of *Smith* v. *South Royalton Bank*[33] that the innocent purchaser from the grantee is not protected. Since the title of the grantor cannot be divested except by the fulfillment of the condition, it follows that the depositary by a wrongful delivery of the deed cannot pass title to the grantee and thus enable the latter to pass it on to the innocent purchaser any more than he can, by refusing to hand over the instrument, keep title from vesting in the grantee of the escrow upon the latter's fulfilling the condition named.

Many of the cases holding the opposite view, that the innocent purchaser in such cases should be protected, rest upon estoppel, as in *Schurtz v. Colvin*,[34] the leading case of the minority view. Here the grantor had not only selected a depositary who wrongfully turned over the deed to the grantee without the performance of the act called for but had placed the grantee in possession of the land. Such a case is quite analogous to that of a vendee of a chattel who leaves the chattel in the possession

[31] *Craddock* v. *Barnes*, 142 N. C. 87, 54 S. E. 1003; *Couch* v. *Meeker*, 2 Conn. 302, 7 Am. Dec., 274.

[32] *Brown Investment Co.* v. *Nat'l Bank*, 47 Wash. 566, 92 Pac. 380.

[33] 32 Vt. 341.

[34] 55 Ohio St. 274.

of the vendor and the latter wrongfully sells it to an innocent purchaser for value. Many courts have held such retention of possession by the vendor to be fraudulent as to *bona fide* purchasers from the vendor.[35] Then, in the case of the grantee's being let into possession and the depositary's wrongful delivery of the deed, an exception might be made and the innocent purchaser be protected. The court, however, in *Schurtz v. Colvin,* said that in such a case the grantor was estopped to deny the delivery. Many other cases cited in support of allowing the innocent purchaser's claim to prevail, like *Blight* v. *Schenck,*[36] really turn on some other point. In that case, the statement of the court in favor of holding the *bona fide* purchaser's right superior to the grantor's was a mere dictum as the grantor had failed to prove that there had been no valid delivery. Other cases that are often cited in support of the innocent purchaser's claim are *Quick* v. *Mulligan,*[37] *Cotton* v. *Gregory,*[38] and *Mays* v. *Shields,*[39] and in each case the grantee had been let into possession or the grantor had already recognized the grantee's possession of the instrument as valid for some purposes.

As already pointed out, if the courts in applying the doctrine of relation back are trying to work out the rights of the parties as equity courts would work them out they should in the case of an innocent purchaser from the grantee who has wrongfully secured the deed from the depositary, protect the innocent purchaser for value rather than the grantor. From the point of view of justice, it would seem that the innocent purchaser's case was a strong one for applying the doctrine of relation back for his protection. We have seen, however, that with few exceptions the courts have not done this. They have rightly held that no title passed by the wrongful delivery. They have acted at least upon the theory that performance of the condition upon the part of the grantee or the happening of the event specified was necessary to take title out of the grantor. In practice, at least, they have really recognized the fact that the grantor had a defeasible fee which could not be cut short by the depositary's delivery of the deed to the grantee. It is submitted then

[35]Uniform Sales Act, Section 25.
[36]Note 9, supra.
[37]108 Ind. 419, 9 N. E. 392.
[38]10 Neb. 126, 4 N. W. 939
[39]117 Ga. 814, 45 S. E. 68.

that it would clarify the law as to delivery of a deed in escrow if courts would cease talking about the doctrine of relation back and recognize the real nature of a delivery in escrow, that the deed is operative as a deed from the first delivery and leaves in the grantor a fee which is subject to be defeated by the grantee's performing the act specified and in no other way.

W. LEWIS ROBERTS

University of Kentucky,
College of Law