THE MERCANTILE USE OF THE CHATTEL MORTGAGE ON AN OPEN STOCK

1. The Legalistic Problems. A mortgage of an open stock involves at least two variations from the customary chattel mortgage transaction in that it requires a mortgage of future or after acquired goods and that it empowers the mortgagor in possession to sell the encumbered goods.

goods. *Qui non habet ille non dat* expresses the result and voices the objection of those cases which at common law denied the validity of the mortgage on after acquired goods. Title was conceived of as quasi-tangible, an indivisible something passed from hand to hand. If there were no goods there could be no title. And if title could not pass to the mortgagee with the conclusion of the mortgage transaction, there could be no mortgage. That materialistic logic was impeccable.

Thus in English common law the mortgage of after acquired goods freed from any problem of a power to sell invested in the mortgagor was said to be invalid even as between the parties. And such decisions prevailed until the House of Lords introduced the doctrine of equitable liens and protected the mortgagee against attaching creditors of the mortgagor. In this country the mortgages likewise have been said to be void even as between the parties, although some of the

Sts. 1894, sec. 4154. But see Ambuehl v. Matthews (1889) 41 Minn. 537, 43 N. W. 477. So the owner of an equitable interest in land may mortgage the crops. *Fields v. Karter* (1908) 121 Ala. 390, 25 So. 800; see *Cleomey v. Rivers* (1924, S. C.) 123 S. E. 759 (rent cotton). The owner of sheep may mortgage the wool to grow upon them; but not the wool to grow upon sheep he may thereafter buy. Cf. *Grantham v. Hawley, supra*; Jones, *Chattel Mortgages* (5th ed. 1908) 203. But the owner of clay in a brick yard has not such potential interest in the finished brick as to enable him to give a valid mortgage on bricks to be manufactured in the future. Townsend v. Allen (1900) 62 Kan. 511, 62 Pac. 1008. This doctrine of potential possession seems a frank exception to the common law rule that one cannot mortgage what he does not have. See *Andrews v. Newcomb* (1865) 32 N. Y. 417, 421; Uniform Sales Act, sec. 5 (3). It was generally held that there could be no valid assignment of future wages or earnings. Mulhall v. Quinn (1854) 67 Mass. 105. Unless the assignor had a contract under which he would receive the wages. Hartley v. Tapley (1854) 68 Mass. 595; but see *Sandwich Mfg. Co. v. Robinson* (1891) 83 Iowa, 597, 49 N. W. 1031 (no contract necessary). We shall not further deal here with these types of future or after acquired goods nor cite any cases involving them.

*"When goods are sold with a chattel mortgage back, the vendee has title to the goods, at least in theory, for some space of time; he then transfers the title or a lien by way of security to the original vendor."* Magill, *Selling on Credit-Legal Advantages* (1923) 8 Corn. L. Quart. 210, 221.

This conception of title has led writers to maintain that one who had not title could not give or pass title. And when the positive decisions of courts indicated, for example, that one who had purchased a negotiable instrument from a thief had title, *ergo* the thief must have had title. See Chafee, *Rights in Overdue Paper* (1918) 31 Harv. L. Rev. 1104, 1112.

The general rule was stated that no chattel mortgage could be executed which would bind personal property not belonging to the mortgagor. Lunn v. Thornton (1845, C. P.) 1 C. B. 379 (mortgagor against mortgagee). . . . "It is a common learning in the law, that a man cannot grant or charge that which he hath not." Perkins, *Conveyancing* (15th ed. 1792) sec. 65.


These statements generally appear in cases involving the rights of third persons. Thus the mortgagee not in possession cannot maintain trover against one interfering with the after acquired goods. Williams v. Briggs (1877) 11
holdings appended “void for indefiniteness.” This invalidity however, did not defeat the mortgagee’s right of satisfaction. The debt could be sued upon, judgment secured, and execution levied upon all of the mortgagor’s property. But while the invalidity of the mortgage did not prevent the mortgagee’s ultimate recovery, it had some practical disadvantages: a valid lien gave security pending suit and did not necessitate new, expensive, and possibly hazardous proceedings. Courts in code states, where fusion between law and equity had been somewhat effected, sustained the mortgage between the parties. These courts harbored the notion that possession without title was fraudulent, at least a badge of fraud, and that one relying upon the


A mortgage professing to cover the “scythes, iron, steel and coal” then owned and also “all scythes, steel, iron and coal” which may be purchased in lieu of aforesaid property was held void for uncertainty in Otis v. Sill (1849, N. Y. Sup. Ct.) 8 Barb. 102, 113 (mortgagee against creditor).

*Nor is the mortgagee ordinarily required to elect whether he will seize the goods as his own under the mortgage or levy on them as the mortgagor’s under a judgment. Case Threshing Machine Co. v. Johnson (1913) 152 Wis. 8, 139 N. W. 445; Magill, op. cit. supra note 2, at p. 222; but see Evans v. Warren (1877) 122 Mass. 303. As between the parties the mortgagee can secure possession by replevin. Judge v. Jones (1897) 99 Tenn. 20, 42 S. W. 4; Campbell v. Quinton (1896) 4 Kan. App. 317. And he can maintain a “law” action against persons taking from the mortgagor with notice. Ludwig v. Kipp (1889, N. Y. Sup. Ct.) 20 Hun. 265 (co-converter with mortgagor); Ludlow v. Rothschild (1889) 41 Minn. 218, 43 N. W. 137 (mortgagee from purchaser with notice); Fuller v. Rhodes (1893) 76 Mich. 35, 43 N. W. 1085 (creditor with constructive notice by recordation); Wiggins Co. v. McMinnville Motor Co. (1924, Or.) 225 Pac. 314 (creditor with actual notice). Compare the cases cited in note 6, supra.

Separation of possession from ownership was early held fraudulent. Twyne’s Case (1604, Star Ch.) 3 Coke, 806. At one time in England it was held conclusively fraudulent as against the creditors of the one in possession. Edwards v. Harben (1785, K. B.) 2 T. R. 387 (conditional sale). This was later overruled, Martindale v. Booth (1832, K. B.) 3 B. & A. 498. In the United States, in general, possession unaccompanied by ownership, is not fraudulent per se. See Williston, Sales (2d ed. 1924) sec. 353 ff. But some courts of equity have adopted a principle, labeled estoppel, which enables creditors to be satisfied out of the property of their debtor, who was allowed by another to remain in possession of goods under such circumstances as to make him the apparent owner. Frelinghuysen v. Nugent (1888, D. N. J.) 36 Fed. 229; Robinson v. Elliott (1874, U. S.) 22 Wall. 513. The basis of the rule is the belief that men get credit for what they apparently own and possess. See Casey v. Casavac (1877) 96 U. S. 407. Nor is it necessary that the creditor establish that he gave credit relying upon such possession. Martin v. Mathoit (1826, Pa. Sup. Ct.) 14 Serg. & R. 214; Williams v. Kirk (1897) 68 Mo. App. 457.
possession of goods by another as *indicia* of prosperity should be satisfied ahead of the one who had made possible such representation. The creditors of the mortgagor, who fell into various categories: prior, contemporaneous, and subsequent to the mortgage, or to its recordation, and who were with or without notice, in general were protected from the mortgagee's claim, but not universally or in all jurisdictions. Where the mortgagee subsequent to the mortgage had taken possession of the goods, or some other sufficient *nouus actus* intervened, the mortgagee was usually but not unanimously protected.

The National
Bankruptcy Act prohibiting preferences cast doubt upon this privilege of the mortgagee if exercised within the statutory term.  

Other courts, however, have interposed, and following the doctrine of Holroyd v. Marshall have allowed the mortgagee to prevail against certain creditors of the mortgagor, although the mortgagee had not taken possession of the goods or the mortgagor done any new act to effectuate the charge.  Massachusetts remained adamant in requiring the intervening act; and New York perversely enough has enforced the

taken by the mortgagee against the will of the mortgagor. Glenn, Rights and Remedies of Creditors (1915) sec. 266 (the case cited does not sustain the proposition); but see Jones, op. cit. supra note 1, sec. 163, note 156. In some states it is considered that the only effect of the mortgage of the after acquired goods is to authorize the mortgagee to take possession. Moody v. Wright (1847, Mass.) 13 Metc. 17.  

It has been suggested that if the mortgagee takes possession within four months of bankruptcy he thereby gains a preference, prohibited under the National Bankruptcy Act. Clark v. Grimes (1916, D. Md.) 232 Fed. 190; cf. Jordan v. Federal Trust Co. (D. Mass. 1924) 296 Fed. 738. And that the insolvent mortgagee's allocation of after acquired goods to the mortgage is an act of bankruptcy. In general see Williston, Transfers of After-Acquired Personal Property (1906) 19 Harv. L. Rev. 557.  

"The ground of the doctrine is that the mortgage . . . . in equity transfers the beneficial interest to the mortgagee . . . . in accordance with the familiar maxim that equity considers done that which ought to have been done." Jones, op. cit. supra note 1, 250. "And as such courts consider that as having been done that which ought to have been done . . . . they treated the assignment as having been made." Thompson, J. in Thompson v. Foerstal (1881) 10 Mo. App. 290, 299. It must be apparent, however, that this maxim states not the reason for such holdings, but merely the result of some of the holdings.  

Mitchell v. Winslow (1847, D. Me.) 2 Story, 630 (mortgagee had taken possession); Perry v. White (1892) 111 N. C. 197, 16 S. E. 172 (purchaser at mortgage sale against mortgagee); Scharfenburg v. Bishop (1872) 35 Iowa, 66 (mortgagee had taken possession); First National Bank v. Turnbull (1880 Va.) 32 Grat. 695 (mortgagee against judgment creditor). Professor Magill suggests that even where the mortgage has been recorded three different results have been reached. (1) The mortgagee prevails over all creditors who have not acquired a property interest before recording. In re Bolstad (1915, W. D. Wash.) 224 Fed. 283. (2) The mortgagee does not prevail against creditors at the time of recordation, even though they acquire their lien subsequently to recordation. Skilton v. Codington (1905) 185 N. Y. 80, 77 N. E. 790. (3) The mortgagee does not prevail against any subsequent claim acquired before recording and without notice. Dempsey v. Pforzheimer (1891) 86 Mich. 652, 49 N. W. 465. Magill, op. cit. supra note 2, at p. 223.  

Moody v. Wright, supra note 14; Blanchard v. Cook (1887) 144 Mass. 207. It is not required, however, that the intervening act shall be the voluntary act of the mortgagor; it is sufficient if the mortgagee has taken possession. Harriman v. Woburn Electric Co. (1895) 163 Mass. 85, 39 N. E. 1004. And see Choynoweth v. Tenney (1866) 10 Wis. 397; Roundy v. Converse (1888) 71 Wis. 524, 37 N. W. 811.
recorded mortgage against purchasers but not against creditors.\textsuperscript{20} It is usually required that the mortgage be definite in the description of the goods to be acquired and limit them to goods of the same class as those now encumbered.\textsuperscript{21} In many states the almost universal requirement of recordation seems to have had the same effect as taking possession by the mortgagor\textsuperscript{22} both as to purchasers and as to creditors, although it has been held that a mortgage of after acquired goods is repugnant and incongruous to the recording statutes.\textsuperscript{23}


\textsuperscript{21} The doctrine of \textit{Holroyd v. Marshall} rests somewhat upon the idea of the power of courts of equity to compel specific performance. \textit{Cf. Williamson v. New Jersey South Ry.} (1878) 29 N. J. Eq. 311. Two distinctions, however, must be noted. The mortgagor does not promise to do any future act, and the court in protecting the mortgagor does not order any additional act done. But the goods to be acquired must be sufficiently described as to enable specific performance. \textit{Phelps v. Murray} (1877, Tenn. Ch.) 2 Coop. 746. Thus a mortgage of "all other personal property which I may own or acquire" does not create a valid lien on any after acquired property. \textit{Ferguson v. Wilson} (1899) 122 Mich. 97, 80 N. W. 1066; \textit{cf. Belding v. Reed} (1865, Exch.) 3 Hurl. & Coll. 954.

"But an agreement to mortgage everything on earth that the mortgagor thereafter might acquire is not a security arrangement at all, rather does it attempt to give the lender a lien upon the borrower's earning power itself; it savors more of vassalage than of hypothecation." Glenn, \textit{op. cit. supra} note 14, at p. 208.

"The effect of recording is generally the same as delivery would be at common law—his lien is valid against all persons, at least in the jurisdiction where recorded." Magill, \textit{op. cit. supra} note 2, at p. 223.

\textsuperscript{22} "The statute provides for filing as a substitute for 'an immediate delivery' or 'an actual and continued change of possession of the things mortgaged'. Such provisions seem to me to exclude the idea of a chattel mortgage upon non-existent things, or that such an instrument could operate to defeat the lien of an attaching, or an execution creditor upon subsequently acquired property." Gray, \textit{J.} in \textit{Rochester Dist. Co. v. Rasey}, \textit{supra} note 20, at p. 579.

"It is idle to say that a resort to the record would have shown the existence of the mortgage, for men get credit by what they apparently own and possess." Davis, \textit{J.} in \textit{Robinson v. Elliott}, \textit{supra} note 10, at p. 525; "Whatever delivery and retention of possession will enable the mortgagor to hold will be equally held by the recorded mortgage. But what cannot be delivered and retained cannot be recorded as what is to be mortgaged. The statute thus making one the
The bestowal of the power to sell upon the mortgagor in possession has been said to be repugnant to the idea of a mortgage. But neither a mortgage nor any other legal device is to be judged by an a priori determination of its character. If remedy be needed, it might be afforded by changing the pre-conceived idea of a mortgage. Nor is the concept of one in possession not having title but nevertheless having the legal power to create an indefeasible interest in the transferee an unfamiliar one. The factor in possession, the conditional vendee empowered to sell, the thief in possession of negotiable paper, the sale of goods at market overt, are current examples. Moreover, since the mortgagee by the contract has authorized the mortgagor to sell, the rights of the purchaser in the regular course of business can be sustained upon simple principles of agency without the necessity of holding the mortgage void as did the recent case of Secord v. Northwestern Tire Co. (1924, Minn.) 199 N. W. 84. Two other types of transfers seem more difficult to reconcile with any theory of agency. The bulk sales purchaser has been condemned by statute as not within the usual course of business, and probably would not be protected. And one who takes a rather large portion of the encumbered stock in the satisfaction of an antecedent debt, especially when the debt was incurred after the recording of the mortgage, would not seem to be within the agency protection extended to a purchaser in the course of business.

Where, however, the mortgagor uses the proceeds of the resale for his own purposes and not in payment on the debt, except so far as

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he maintains the stock to an agreed value, it may be argued that the mortgagee becomes an investor in the business and as such deserves to hazard the risks of unsuccessful management. Thus the holder of a bottomry bond in admiralty takes it subject to the risks of the voyage. On the other hand the mortgagee of the real estate owned and

Hogdon v. Libby (1896) 69 N. H. 136, 43 Atl. 312 (assignee in insolvency). But in general creditors and purchasers for value prevail over the mortgagee. Cross v. Berry Demensville & Co. (1901) 132 Ala. 93, 31 So. 96; Chapin v. Jenkins (1893) 50 Kan. 385, 31 Pac. 1284 (assignee for creditors); Kuh v. Garvin (1894) 123 Mo. 547, 28 S. W. 847 (creditors prevail over those mortgagees who had not taken possession); Belknap v. Lyell (1906) 89 Mo. 118, 42 So. 799; Enck v. Gerdin (1902) 67 Ohio St. 245, 65 N. E. 880; Ramsey-Altun Co. v. Watson (1901) 10 Okla. 675, 65 Pac. 98; Citizens Trust Co. v. Elders (1925) 212 Mo. App. 589, 259 S. W. 136. Such mortgages are generally said to be fraudulent as a matter of law. Williston, Transfers of After-Acquired Property (1906) 19 Harv. L. Rev. 557, 571, note 1. But a few cases do not condemn the mortgage as fraudulent per se. Louden v. Vinton (1896) 108 Mich. 313, 65 N. W. 222 (mortgagee had taken possession); First National Bank v. Stewart (1906) 13 N. M. 551, 86 Pac. 622 (mortgagor prevails over attaching creditor). And some states sustain the mortgage against creditors. Carroll v. Anderson (1923, Wyo.) 218 Pac. 1098. Nor will a power to sell the goods be implied from their perishable nature. Houck v. Heinsman (1893) 37 Neb. 463, 55 N. W. 1062. Where the mortgage provides that the mortgagor must account for the proceeds of sales many courts sustain the mortgage. Hixon v. Hubbell (1896) 4 Okla. 224, 44 Pac. 222 (mortgage had been taken possession); New Albany Woolen Mills v. Lewis (1896) 99 Ky. 398, 36 S. W. 12 (ibid.); Currie v. Bowman (1894) 25 Or. 354, 35 Pac. 846; Rock Island Bank v. Powers (1896) 134 Mo. 422, 34 S. W. 859 (creditors prevail over mortgagees). And it may be sufficient if the mortgagor account only for the net proceeds of such sale. See Manhattan Brass Co. v. Webster Co. (1889) 37 Mo. App. 145. But if the mortgagor fails to so account with the mortgagee's knowledge the mortgage is invalidated. Ryan v. Rogers (1908) 14 Idaho, 399, 94 Pac. 427. But not if the mortgagee was unaware of the default. Atchison Saddlery Co. v. Gray (1901) 63 Kan. 79, 64 Pac. 987. Where the mortgage contains an agreement by the mortgagor to maintain the stock to a certain value some courts have held it to imply a power to sell and thus invalidate the mortgage. Garden v. Bodwing's Admr. (1896) 9 W. Va. 121. Other courts do not make such an inference. Kalk v. Fielding (1888) 50 Wis. 339; cf. Jaffray v. Greenbaum (1884) 49 Iowa, 452. And such provisions have been held valid. Fleisher Bros. v. Hinde (1906) 122 Mo. App. 218, 98 S. W. 251; contra: Skilton v. Coddington, supra note 18. Where the mortgagor has taken possession prior to the attachment by creditors a few courts have held it ineffectual, denying power to validate the void transaction. Rathbun v. Berry (1892) 49 Kan. 735, 31 Pac. 679; Wilson v. Voight (1896) 9 Colo. 614. Others have protected the mortgagee in possession. Francisco v. Ryan (1896) 54 Ohio St. 307, 43 N. E. 1045; Louden v. Vinton, supra; Hixon v. Hubbell, supra; New Albany Woolen Mills v. Lewis, supra. So as to the effect of recording some courts have held it ineffectual to validate the void mortgage. Freeman v. Rawson (1855) 5 Ohio St. 1; Duncan Wyatt & Co. v. Taylor (1885) 63 Texas, 645; but see Mitchell v. Winslow, supra note 18.

*The Dora (1887, E. D. La.) 34 Fed. 343; Hughes, Admiralty Law (2d ed. 1920) 384, 394; see Beach, Relative Priority of Maritime Liens (1924) 33 Yale Law Journal, 841.*
occupied by a mercantile concern is not subject to the risks of the business. The mortgage of an open stock of goods is essentially a mortgage on the going concern value, only in event of catastrophe is it contemplated that resort shall be had to the goods. The lender, instead of putting in his goods as a capital contribution, puts them in only when his risk is secured by a mortgage. The commercial enterprise thus embarks with a first lien in favor of one of its investors on all of its property. The courts cannot refuse such a prior lien if there is no more than a recorded mortgage upon then existing tangible goods; but when after required goods are sought to be added and a power to sell inserted, some have held the lien on all of the goods void;\textsuperscript{30} others, while recognizing the lien as to the presently owned goods,\textsuperscript{31} have refused to permit the after acquired goods to be realized on ahead of the creditors. But the legal problems can scarcely be solved until the mercantile function of this instrument of credit is known. If it alone affords the small merchant a feasible way of financing himself and yet securing his wholesalers, there are cogent reasons for sustaining its use.\textsuperscript{32}

\textit{(To be continued)}

\textbf{J. F. C.}

\textbf{DOES THE 33RD SECTION OF THE MERCHANT MARINE ACT (THE JONES ACT) APPLY TO PROCEEDINGS IN ADMIRALTY?}

It is proposed to discuss a portion of the reasoning of the United States Supreme Court in the case of \textit{Panama Railroad Company v. Johnson} (1924) 264 U. S. 375, 44 Sup. Ct. 391, construing the above act.

The statute is as follows:\textsuperscript{3}

"That any seaman who shall suffer personal injury in the course of his employment may, at his election, maintain an action for damages at law, with the right of trial by jury, and \textit{in such action} all statutes of the United States modifying or extending the common law right or remedy in cases of personal injury to railway employees shall apply; and in case of the death of any seaman as a result of such personal injury the personal representative of such seaman may maintain an action for damages at law with the right of trial by jury, and \textit{in such action} all statutes of the United States conferring or regulating the right of action for death in the case of railway employees shall be applied in like manner."


\textsuperscript{31} See \textit{Hayes v. Westcott} (1890) 91 Ala. 143, 8 So. 337; \textit{R. C. L.} 438, note 8.

\textsuperscript{32} "Many small merchants, especially beginners in business, have no other means of securing their creditors for the stock they purchase, and can meet their debts out of current sales. . . . To hold that a merchant cannot mortgage his goods without closing his doors, would be to hold that no mortgage of a merchant's stock can be made at all." \textit{Campbell, J. in Gay v. Bidwell} (1859) 7 Mich. 519, 525.

Johnson was a seaman, and brought an action in the United States District Court for the Eastern District of New York on its common law side to recover for injuries, received while at work on a vessel of the Panama Railroad Company, due to an alleged defective ladder. The principal office of the Company was in the Southern District. It defended on the grounds:

(i) That the forum named in the act was exclusive and not a mere matter of personal privilege which could be waived by a general appearance;

(ii) That the act was unconstitutional
   (a) As destructive of the admiralty and maritime jurisdiction;
   (b) As in violation of the Fifth Amendment;
   (c) As too vague and uncertain to constitute due process of law.

The Supreme Court held that the failure to appear specially waived any question of the forum, and that the act was not obnoxious to the constitutional objections urged against it. The writer is in accord with the result at which the Court arrived. His only quarrel is with a part of its reasoning which, in his judgment, was not necessary to a vindication of the act, and which, he fears, may have an unfortunate tendency.

The attack upon the act on the ground of its interference with the admiralty jurisdiction is based upon the contention that it introduces a new principle of liability into the admiralty law, and enables the seaman to have the new principle litigated under a different system from that prevailing in an admiralty court and in a different court, or (as stated in the opinion) "It restricts the enforcement of rights founded on them to actions at law, and thereby encroaches on the admiralty jurisdiction intended by the Constitution."

The opinion first establishes clearly the right of Congress to modify the general law of the sea within certain bounds, and concludes this part of the discussion as follows:*  

"Rightly understood the statute neither withdraws injuries to seamen from the reach and operation of the maritime law, nor enables the seamen to do so. On the contrary, it brings into that law new rules drawn from another system and extends to injured seamen a right to invoke, at their election, either the relief accorded by the old rules or that provided by the new rules."

But in answer to the contention that the act encroached on the jurisdiction of the admiralty court by limiting the enforcement of the new

*Italics are those of the writer.
right to a common law forum, the Court felt called upon to vindicate
the validity of the act by holding that it applied to libels in admiralty
as well as to actions at common law. Replying to the contrary con-
tention it says: 3

"It must be conceded that the construction thus sought to be put
on the statute finds support in some of its words, and also that if it
be so construed a grave question will arise respecting its constitutional
validity . . . . The question arises, therefore, whether the statute is
fairly open to such a construction . . . . The course of legislation,
as exemplified in Section 9 of the Judiciary Act of 1789, Sections 563
(par. 8) and 711 (par. 3) of the Revised Statutes, and Sections 24
(par. 3) and 256 (par. 3) of the Judicial Code, always has been to
recognize the admiralty jurisdiction as open to the adjudication of all
maritime cases as a matter of course, and to permit a resort to common-
law remedies through appropriate proceedings in personam as a matter
of admissible grace. It therefore is reasonable to believe that had
Congress intended by this statute to withdraw rights of action founded
on the new rules from the admiralty jurisdiction and to make them
cognizable only on the common-law side of the courts, it would have
expressed that intention in terms befitting such a pronounced depar-
ture,—that is to say in terms unmistakably manifesting a purpose to
make the resort to common-law remedies compulsory, and not merely
permissible. But this was not done. On the contrary, the terms of
the statute in this regard are not imperative but permissive. It says
"may maintain" an action at law "with the right of trial by jury," the
import of which is that the injured seaman is permitted, but not
required to proceed on the common law side of the court with a trial
by jury as an incident. The words "in such action" in the succeeding
clause are all that are troublesome. But we do not regard them as
meaning that the seaman may have the benefit of the new rules if he
sues on the law side of the court, but not if he sues on the admiralty
side. Such a distinction would be so unreasonable that we are unwill-
ing to attribute to Congress a purpose to make it.

A more reasonable
view, consistent with the spirit and purpose of the statute as a whole,
is that the words are used in the sense of "an action to recover damages
for such injuries," the emphasis being on the object of the suit rather
than the jurisdiction in which it is brought. So we think the refer-
ence is to all actions brought to recover compensatory damages under
the new rules as distinguished from the allowances covered by the
old rules, usually consisting of wages and the expense of maintenance
and cure . . . In this view the statute leaves the injured seaman free
under the general law—Sections 24 (par. 3) and 256 (par. 3) of the
Judicial Code . . . . to assert his right of action under the new rules on
the admiralty side of the court."

This promulgation of a procrustean rule applicable alike to common
law and admiralty courts is not necessary to vindicate the validity of
the statute. From the time of the Judiciary Act, where the right to
a common law remedy was first recognized, it has never been held
that either the rule of liability or the measure of recovery had to be

3Ibid., at p. 390, 44 Sup. Ct. at p. 395.
the same in the common law and admiralty courts. In a collision case you can sue at common law or libel in admiralty; but if it develops that both are in fault, you recover half damages in admiralty and fail at common law. A passenger injured on a ship fails if he sues at common law and is guilty of contributory negligence, but recovers damages in admiralty proportioned to the relative degrees of negligence of the parties. The right of Congress to create a new cause of action and limit its enforcement to a certain forum ought to be clear. This is not "withdrawing" anything from the admiralty; for you cannot withdraw a thing from a party who never had it. The very next sentence of this statute limits a death action to the common law court, for it gives no election like the first sentence. And yet the jurisdiction of the admiralty courts over death actions on navigable waters has been repeatedly recognized by the Supreme Court.

The opinion and briefs of counsel assume that the Federal Employers Liability Act is the one adopted by the statute. This being true, where are we landed by this opinion applying the words "in such action" to libels in admiralty? Prior to this act, the maintenance and cure doctrine gave the seaman a limited right of recovery for a personal injury even where he was solely negligent. It also gave him a right in case of sickness to medical treatment and wages. But

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4 The moiety rule of damages in collision cases was established in this country by Mr. Justice Nelson's opinion in The Catharine v. Dickinson (1854, U.S.) 17 How. 170. The principle of that decision has been uniformly followed. The North Star (1882) 106 U.S. 17, 1 Sup. Ct. 41. And even extended to include suits by passengers injured in the collision of equally negligent vessels. The Washington (1869, U.S.) 9 Wall 513.


6 The lower federal courts at first were in conflict on this point, the greater number of them allowing a proportionate recovery subject to the discretion of the trial judge. The Truro (1887, E. D. N. Y.) 31 Fed. 158; The Wanderer (1884, E. D. La.) 20 Fed. 140; contra: Peterson v. Chandos (1880, D. Or.) 4 Fed. 645. The Supreme Court decided the question in favor of the majority. The Max Morris v. Curry (1890) 137 U.S. 1, 11 Sup. Ct. 29.

7 No recovery for a wrongful death may be had in admiralty without the aid of a statute. The Harrisburg (1888) 119 U.S. 199, 7 Sup. Ct. 140. But the Supreme Court has asserted jurisdiction of such causes and has applied state statutes in granting relief. Great Lakes Dredge & Dock Co. v. Kieriejewski (1923) 261 U.S. 479, 43 Sup. Ct. 418.

8 The Chico (1905, N.D. Calif.) 140 Fed. 568. In these cases, as in those to which the fellow-servant rule would be a complete defense at law, the recovery is only expenditures on hospital charges and medical services. City of Alexandria (1889, S.D. N.Y.) 17 Fed. 390.

9 These unusual advantages given to ailing seamen apparently were introduced into American admiralty law by Mr. Justice Story, in an opinion exhaustively reviewing the law of the then principal maritime nations. Harden v. Gordon (1823, C. C. D. Me.) 2 Mason, 541. In elaborating the principles, he said: "The title to be cured at the expense of the ship is co-extensive with the service
the Federal Employers Liability Act bases the right of recovery for personal injuries upon some negligence or disregard of statutory precautions by the employer. If it “applies” to libels in admiralty for personal injuries to seamen, the admiralty court must “apply” it in its entirety, and limit his recovery for personal injuries to cases involving some element of negligence on the part of the employer; for the maintenance and cure doctrine, like Noah’s weary dove, can find no resting place above its cheerless waters. And so the result of this construction is to destroy the seaman’s right to treatment for personal injuries under the maintenance and cure doctrine and limit that doctrine to the privilege of medical treatment during sickness. True, the opinion in a previous sentence (quoted ante) speaks of his right to invoke the old rules, but nevertheless the result stated must, it is submitted, logically and inevitably follow.

The words “in such action” occur three times in the statute under consideration. Congress must have meant them to have the same meaning in all three places. It is well known that a seaman may proceed either in rem or in personam in the admiralty to enforce any rights that he may have arising out of a personal injury. Hence, if the words “in such action” mean what the court says, the last sentence to the statute may be thus expressed: Jurisdiction in a common law action under the statute or in a libel in rem or in personam in admiralty shall be under the court of the district in which the defendant employer resides, or in which his principal office is located. And so, if the Court is right, the seaman can libel in rem only when his ship happens to come to the owner’s home port, and not in any port where he may catch her!

The inclusion of proceedings in admiralty in the word “action” is a departure from previous practice. In the lexicon of admiralty there is no such word. It will be sought vainly among the Admiralty Rules of the Supreme Court. The Constitution speaks of “cases of admiralty and maritime jurisdiction.” The Judiciary Act of 1789 calls them “causes of admiralty jurisdiction.” They are frequently in the ship. The seaman is to be cured for injuries and sickness occurring while he is in the ship’s service. It is the benefit from the service which constitutes the ground-work of the claim. . . . The sickness or other injury may occasion a temporary or permanent disability; but that is not a ground for indemnity. They are not in any just sense liable for consequential damages.” Reed v. Canfield (1832, C. C. D. Mass.) 1 Summ. 195, 198. The doctrine was adopted by the Supreme Court in The Osceola (1902) 189 U. S. 158, 23 Sup. Ct. 483. The lower courts regularly apply it. The Luckenbach (1910, C. C. A. 4th) 178 Fed. 1004, 101 C. C. A. 663.

described as “suits in admiralty.” If there is any instance in the statutes where they are spoken of as “actions,” it has escaped the writer’s attention.14

In 

\textit{Atkins v. Disintegrating Co.}\textsuperscript{5} it was held that the provision forbidding suits against a defendant in any other district than that whereof he is an inhabitant did not apply to proceedings in admiralty, and did not prevent an admiralty proceeding by foreign attachment wherever any assets of the debtor could be found. In \textit{Re Louisville Underwriters}\textsuperscript{6} it was held to the same effect, and that a libel \textit{in personam} could be instituted against a foreign corporation wherever service could be had. If therefore the words “in such action” include an admiralty proceeding, the seaman must bring his libel \textit{in personam} for personal injuries in the district in which the defendant employer resides or in which is his principal office, and cannot acquire jurisdiction in any other district or in a foreign port by a process of foreign attachment; and the above decisions are inapplicable in view of the concluding sentence of the act in question.

Prior to this decision, the meaning of the act could hardly have been considered doubtful. Its simple and natural construction is, that the seaman may proceed at common law to recover damages for personal injury where under similar circumstances a railway employee could recover (involving some element of negligence on the part of the employer); but with an election to proceed in the admiralty to enforce his rights under the maintenance and cure doctrine as theretofore applied in the admiralty courts (not necessarily involving any element of negligence). It is a good illustration of a rule of construction going back as far as Coke on \textit{Littleton}: “Quoties in verbis nulla est ambiguitas, ibi nulla expositio contra verba fienda est.”

It is noteworthy that the construction put upon the act by the Court in the particular case under discussion appears for the first time in this opinion. Neither the opinion of the lower court nor the briefs of counsel in the Supreme Court show a trace of it.

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\textbf{Norfolk, Va.}
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\textbf{Robert M. Hughes.}
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1 The English courts have also held that the term “action” did not apply to admiralty proceedings. Lord Esher, in discussing a private act said: “The word ‘action’ mentioned in the section in question was not applicable, when the Act was passed, to the procedure of the Admiralty Court. Admiralty actions were then called ‘suits’ or ‘causes’; moreover the Admiralty Court was not called and was not one of His Majesty’s courts of Law.” \textit{The Longford} (1889, C. A.) L. R. 14 Prob. Div. 34, at p. 37. In a later case it was held that the word “actions” in section 101 of the County Courts Act of 1888 did not include actions on the Admiralty side of that Court. \textit{The Theodora} [1897] P. 279.

2 (1873, U. S.) 18 Wall. 272.

3 (1890) 134 U. S. 488, 10 Sup. Ct. 587.
THE JUVENILE COURT IN NEW YORK

A recent juvenile court provision in N. Y. Laws, 1924, ch. 254, gives to New York City a much advanced type of legislation in this field. An examination of the New York statutes clearly reveals the antecedent evolution in intelligent social policy toward wayward children. A statute passed in 1877, requiring separate treatment of child and adult offenders, first indicated the realization of the danger of exposing impressionable minds to hardened criminals. By 1892 sufficient progress had been made to provide for separate trials and dockets for child offenders. Another phase of development was reached with the establishment in 1902 of the first children's court in the United States to have a separate building and administrative independence of any other court. The present act, giving almost complete independence from other courts, and providing that all actions be civil instead of criminal, broadly represents the features found most successful in prior enactments. The statute provides for the creation of the necessary court machinery, confers practically exclusive jurisdiction over all children sixteen years of age or under, and provides suitable non-penal systems of parole and institutional commitment.

The essential officers include six full time justices, a probation staff, and medical advisers. There is no jury. The court is, in short, the

1 Origin of the Juvenile Court and Laws for the Betterment of Children (1907) 40 Chic. Legal News, 177.
2 N. Y. Laws, 1877, ch. 408.
4 N. Y. Laws, 1902, ch. 590.
5 N. Y. Laws, 1924, ch. 254, sec. 7.
6 Ibid., sec. 56, “No child shall be denominated a criminal by reason of .... adjudication, nor shall such adjudication be denominated a conviction.”
8 As in several other states, crimes punishable by death or life imprisonment are specifically excepted. N. Y. Laws, 1924, ch. 254, secs. 2, 7; Mass. Gen. Laws, 1921, ch. 119, sec. 74. And others allow the judge in his discretion to surrender jurisdiction. See Ohio Gen. Code, 1921, sec. 1681.
9 Ibid., sec. 2. Fourteen other states place the age limit at 16 years; thirteen at 17 years; eighteen at 18 years; and one at 20.
10 The constitutionality of such statutes is now well established. This illustrates the familiar doctrine that a chancery court acting as parens patriae has powers superior to those of the natural parent when necessary to aid or protect the child. 18 L.R.A. (N.S.) 886, note; 45 L.R.A. (N.S.) 908, note.
11 Only high grade lawyers of at least five years practice are eligible, the salary being $12,000 a year; in sharp contrast to over-worked police court judges. N. Y. Laws, 1924, ch. 254, sec. 6; Conn. Gen. Sts. 1918, sec. 189.
12 Much conflict has arisen as to the right of a juvenile to a jury trial. Although nearly half of the states provide for jury trials, it seems that the informal nature
focal point of a combined legal and sociological system, before which the child comes, not to be prosecuted, but as a subject of scientific investigation and sympathetic treatment. The importance of skilled medical examinations is evidenced by the fact that of one group of 126 offenders before the Chicago Court, of an average age of 18.95 years, tests revealed an average mental development of 12.6 years. Fortunately, New York, in line with some twenty-six other states, sees the possibilities of crime prevention by curing child defectives, and has provided for medical examination and treatment in its new statute. At the same time, probation officers are created to investigate the environment of offenders. That the effect of harsh surroundings is of no petty nature is shown by the number of felonies coming before the Chicago Juvenile Court—1374 in 1914, and 1784 in 1915. Often a complete reclamation can be achieved by environmental change, and in any event a proper disposition of the particular case can be made only if all the available facts are brought to bar with the offender.

Once the preliminary history is secured, the procedure should be adapted to win the child's cooperation in discovering the cause of his offense and the best method of correction. To this end, the new statute excludes spectators and brings the child informally before the two or three necessary court officers. It is to be hoped that the power of the justices to establish procedural rules will be exercised to abandon the usual strict rules of evidence. Decisions refusing to recognize a privilege from repeating children's confidences might seriously impair the practical attainment of juvenile court ideals. At the conclusion of the trial the court faces its most difficult task. After examining the child's testimony in the light of the previously secured physical and
environmental data, treatment for the individual case must be prescribed. Other than dismissal, the three major possibilities under the New York statute are appointment of a guardian, institutional commitment, and probation.20

A guardianship under an individual or association is often a most satisfactory disposition of orphans or children whose parents have been decreed unfit for their care.21 It usually involves custody of both the person and the property of the child, though some states give control of the person only.22 Altogether, about twenty-three states regularly make use of this remedy,23 although the difficulty of securing competent guardians has greatly lessened its frequency of application. Institutional commitment provides both hospital treatment for defectives24 and institutional control for neglected children and delinquents.25 The former is prescribed until a cure is effected, and the latter usually is ordered during minority. The whole theory of such confinement is based upon the child's susceptibility to good training. Consequently, inmates are subjected to regular habits of living, taught useful trades, and in every way encouraged to become useful citizens upon their release.

England uses this type of treatment very generally under the name of the "Borstal System."26 Yet at its best, institutional treatment is often unsatisfactory. Hence where possible, such commitment as well as guardianship is being increasingly avoided in favor of probation,27 which leaves the child in his home subject to more or less strict control by a probation officer.28 Given competent officers, it may well be said that "probation is now recognized to be the surest as well as the most economical means of reformation."29

The New York statute exemplifies much that is best in juvenile legislation. But "the passage of laws . . . alone cannot guarantee good work. Intelligent cooperation from the community is also essential if year in and year out efficient service is to be rendered."30

20 In the new statute, sec. 24 (d) provides for a fine, and sec. 24 (f) allows discharge to an official as a public charge, among other remedies.

21 The power to select a guardian is conferred in sec. 7 (1) and sec. 24 (g) of the statute.

22 Idaho Laws, 1919, ch. 161, secs. 8, 12.

23 Waters, Juvenile Court Procedure (1922) 13 Jour. Crim. L. 44.

24 Supra note 14.

25 For the statutory definition of "neglected" and "delinquent," see N. Y. Laws, 1924, ch. 254, sec. 2 (4).


27 The N. Y. statute, sec. 24 (g) permits decrees of probation for not more than 5 years, or until majority.

28 A question has been raised elsewhere whether such control decreed during minority could be defeated by the child's marriage, but the better view seems to deny any such effect. Re Willis (1916) 30 Calif. App. 188, 157 Pac. 819; (1918) 25 Case and Comment, 35.

29 Emerson, Children's Court Work (1918) 9 Jour. Crim. L. 105.

30 (1915) 6 Jour. Crim. L. 444.
JOINDER OF PARTIES AND TRIAL BY JURY

A recent New York decision following the liberal rule adopted from the English reformed procedure reveals clearly the problems arising from the greater freedom of joinder of parties permitted under the new Civil Practice Act. In *Akely v. Kinnicutt* (1924) 238 N.Y. 466, 144 N.E. 682, one hundred and ninety-three plaintiffs joined in an action for damages against the defendant who had induced them severally to purchase varying amounts of stock by circulating an alleged fraudulent prospectus. The complaint set up one hundred and ninety-three different causes of action, one in favor of each plaintiff. The court decided that the joinder was proper and affirmed the lower court's denial of the defendant's motion for severance of the causes of action on the ground of misjoinder of parties plaintiff. The defendant objected that the court had unfairly deprived him of a new jury for each cause of action. With reasonable distress he declared that he "will be faced with the uncertainties of a trial before a single jury in an action brought by a horde of plaintiffs all shouting that they have been defrauded and tricked by wealthy and unscrupulous defendants" and that "confronted with all of these causes of action at one trial any jury might readily, though incorrectly, gain the impression that where there is so much smoke there must be some fire." The constitutionality and even the desirability of section 209 of the Civil Practice Act is fairly questioned by such procedural limitations of the right to trial by jury.

It seems that the legislatures, upheld by the courts, have already subjected the right of trial by jury to more serious restrictions than the defendant here complains of. It would be surprising, therefore, if the legislature could not direct the procedural administration of jury

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1 For the present English rule see The Annual Practice (1924) Order 16, rule 1.
2 "All persons may be joined in one action as plaintiffs, in whom any right to relief in respect of or arising out of the same transaction or series of transactions is alleged to exist whether jointly, severally or in the alternative, where if such persons brought separate actions any common question of law or fact would arise. . . . ." N.Y. C.P.A. 1921, sec. 209. Before the new Civil Practice Act the general code rule in New York permitted a joinder of parties and actions only where the plaintiffs had a common interest in the subject of the action and in the relief demanded. For a more comprehensive discussion of joinder of parties and actions see Comments (1923) 32 Yale Law Journal, 384; Sunderland, Joinder of Actions (1920) 18 Mich. L. Rev., 571; Clark, The Code Cause of Action (1924) 33 Yale Law Journal, 817.
3 Appellant's brief before the Court of Appeals, p. 8.
4 "The trial by jury in all cases in which it has been heretofore used shall remain inviolate forever." Constitution of New York (1846) Art. 1, sec. 2.
5 Act extending the jurisdiction of justice of the peace courts employing a jury of six. N.Y. Laws, 1861, ch. 158; Dawson v. Horan (1868, N.Y.) 51 Barb. 459. The special jury act regulating the mode of selecting jurors for special jury service, limited the eligibility of citizens of certain localities to
trials to render them more efficient. As a jury is substantially provided, the liberal construction of the Practice Act, in an endeavor to achieve the greatest convenience in trials, does not burden the defendant. If all the plaintiffs had assigned their rights of action to one person, a single jury would have heard all the claims. How, then, are the defendant's constitutional rights impaired by the procedure adopted in the instant case? On speculation, it is even conceivable that the combined attack of "this mob of plaintiffs" might appeal to the sporting instincts of the jury and direct its sympathy to the defendant.

The standard of joinder in the instant case is properly one of convenience applied to a series of claims arising from closely related transactions involving the same questions of law and fact. The evidence on the issue of the prospectus, the main issue of each case around which the greatest struggle is centered, would be identical in each of the one hundred and ninety-three causes of action. The disposition of this mass of evidence at one time in itself shows that the Practice Act and this case following it are sound in principle.

Although the decision is therefore to be commended, the objections of the defendant against a trial before a single jury seem of some substantial weight. The procedure best adapted to obviate these objections would be a motion to split the issues and to try the common

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the jury list and interfered with the right of challenging jurors enjoyed under the common law. N. Y. Laws, 1896, ch. 378; People v. Dunn (1899) 157 N. Y. 528, 52 N. E. 572. Indeed, laws denying a jury trial altogether were held constitutional as correct procedural measures. An act providing for a reference of controversies between the receivers of insolvent insurance companies and their stockholders. N. Y. Laws, 1862, ch. 412; Sand v. Kimbark (1863) 37 N. Y. 147. See also Mechanics Lien Act, N. Y. Laws, 1885, ch. 342; Schillinger v. Arnott (1897) 152 N. Y. 584, 46 N. E. 956. See Scott, Fundamentals of Procedure in Actions at Law (1922) 70 et seq.

*The Seventh Amendment, indeed, does not attempt to regulate matters of pleading or practice, or to determine in what way issues shall be framed by which questions of fact are to be submitted to a jury. Its aim is not to preserve mere matters of form and procedure but substance of right. This requires that questions of fact in common law actions shall be settled by a jury, and that the court shall not assume directly or indirectly to take from the jury or to itself such prerogative. So long as this substance of right is preserved the procedure by which this result shall be reached is wholly within the discretion of the legislature, and the courts may not set aside any legislative provision in this respect because the form of action—the mere manner in which questions are submitted—is different from that which obtained at the common law." Brewer, J. in Walker v. Southern Pacific R. R. (1897) 165 U. S. 593, 596, 17 Sup. Ct. 421, 422. See Scott, op. cit. supra note 5, at p. 74.


*All but twelve of the plaintiffs live outside of New York state, some as far away as California and even Canada. Their claims vary in amount from $50 to $75,000. The obvious impracticability of expecting many of these plaintiffs to bring separate actions is a further reason for justifying a joinder.
issue of the prospectus for all the claims at once before the jury. If the finding on the prospectus should establish its honesty, the whole action might be ended with dispatch. But if the finding should be adverse to the defendant, the accessory facts in each claim would be considered in light of the finding on the prospectus, and might be quickly and fairly disposed of one at a time. The court would not be justified in upholding the defendant's objections by assuming that the jury would be governed by its feelings to the exclusion of its reason and would be impressed by numbers alone. Nor should it assume that the trial court would be unable to present the issues clearly to the jury or that the jury would refuse to follow the instructions. If the unusually large number of claims did appear to prejudice the jury so that it no longer occupied an impartial position, the judge would not only have the power, but it would be his duty under the Practice Act to stop the proceedings and order separate trials on the several claims.

It is possible that the defendant might avoid a jury trial altogether by filing a counterclaim in the nature of the old equitable bill of peace to obtain a settlement on a single comprehensive issue of so many troublesome claims. Thus an equitable issue would be presented for trial. He might also attempt to present an equitable issue by counterclaiming for a declaratory judgment on the issue of the prospectus alone. It is not settled, however, that the remedy of the declaratory judgment is purely equitable. A declaration finding the prospectus

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8 Smith v. Western Pacific Ry. (1911) 203 N. Y. 499, 96 N. E. 1106. "The court, in its discretion, may order one or more issues to be separately tried prior to any trial of the other issues in the case." N. Y. C. C. P. 1907, sec. 973; N. Y. C. P. A. 1921, sec. 443 (3); see 2 Conn. Gen. Sts. 1918, sec. 575.

10 If the finding on the prospectus was adverse to the defendant he might also well choose to settle the individual claims rather than go to the expense of trying each claim. In fact his position before the court and jury might be seriously prejudiced if he continued to litigate each claim after the main issue was decided against him.

12 "... provided that if upon the application of any party it shall appear that such joinder may embarrass or delay the trial of the action, the court may order separate trials or make such other order as may be expedient, and judgment may be given for such one or more of the plaintiffs as may be found to be entitled to relief, for the relief to which he or they may be entitled." N. Y. C. P. A. 1921, sec. 209.


valid would save everyone concerned in the action a considerable amount of time and expense, and a declaration either way would operate largely to settle the main issue of the suit without prejudicing the defendant's case with a jury trial.

As the various claims arose from the defendant's one act of disseminating the alleged fraudulent prospectus, question arises whether the plaintiff might not have alleged only a single cause of action. Out of abundant caution he alleged one hundred and ninety-three causes of action, and the resulting complaint comprised one thousand and ninety folios covering three hundred and sixty-four pages of the printed record. Of the eighteen paragraphs alleged in each cause of action, sixteen were identical. The other two differed in each instance as to the separate allegations of purchase and as to the number of shares bought at the different times entailing a consequent difference in the damage suffered by each plaintiff. This identity of allegation was properly relied on as showing that a large proportion of the evidence offered in each case would be the same as to each right of action alleged. A view of the cause of action as referring to the operative facts giving a right to relief might well lead to the conclusion that since the ground of suit is substantially identical in all the claims there is only one cause of action, a conclusion which would here render permissible a desirable simplification of the complaint.

APPORTIONMENT OF STOCK DIVIDENDS BETWEEN LIFE TENANT AND REMAINDERMAN

A recent decision of the Supreme Court of Ohio has upset an almost unanimous trend of twenty-five years duration. Deciding the question for the first time in that Court, and reversing what was apparently the opposite tendency in its lower courts, it has adopted in Lamb v. trial in actions for declaratory judgments as discretionary with the court. Since courts ordinarily refuse to make declarations purely of fact where no legal relations are involved, the request for a declaration should be carefully framed to present an issue concerning the legal relations of the parties. See Borchard, op. cit. supra, at p. 115.

Paragraphs 1-14 of the first cause of action are incorporated by reference in each of the succeeding causes of action. Paragraphs 15 and 17 are repeated in each cause of action and would have been incorporated by reference if it had not been necessary to use the words "this plaintiff" in referring to the particular plaintiff in question.

This view is developed in Clark, The Code Cause of Action (1924) 33 Yale Law Journal, 817. It was applied by the New York Court of Appeals in Cleveland Cliffs Iron Co. v. Kench (1923) 237 N. Y. 533, 143 N. E. 731, noted in (1923) 126 Court of Appeals Records, 1, although, as Professor Clark points out, the cases are in much confusion on this subject.

Excellent statements of the rules in this subject, their variations, and supporting cases, have appeared in Comments (1924) 33 Yale Law Journal, 774; Notes (1925) 23 Col. L. Rev. 369; 50 L. R. A. (N. S.) 510; 2 Cook, Corporations (8th ed. 1923) sec. 552-556.

Lehmann (1924, Ohio) 143 N. E. 276, the Massachusetts rule that a dividend payable in stock of the declaring company is capital. As such, it goes to the remainderman under a trust estate, not to the life tenant. The decision rests squarely on the doctrine that the directors of a corporation are the final authority as to finances within the corporation. When they vote not only not to distribute surplus earnings, but to use such funds permanently as capital, it is beyond the province of the court to rule that earnings have been disbursed.

The Pennsylvania-New York rule, commonly called the apportionment rule, gives stock dividends to the life tenant so long as the value of the corpus is not impaired. The courts adopting this view reject the vote of the directors as having any force in the division of the estate between the life tenant and remainderman. Between the latter it is a question for the court to decide exactly what the testator meant when he stipulated “income” to the life tenant.

The apportionment rule is unfortunately blessed with an implication of fairness. What could be fairer than to give the life tenant the earnings over and above the unimpaired corpus of the trust? But observation of the actual application of the rule raises some doubt as to its inherent fairness.

In applying the apportionment rule the courts

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Footnotes:


4 The Ohio court also found assistance in the holding of the United States Supreme Court in accord. Gibbons v. Mahon (1890) 136 U. S. 549, 10 Sup. Ct. 1057. And in the holding of the same court that stock dividends are not income for purposes of taxation. Towne v. Eisner (1918) 245 U. S. 418, 38 Sup. Ct. 158.


6 McLouth v. Hunt, supra note 5.

7 The testator may, of course, stipulate to whom a stock-dividend shall go. The difficulty arises out of the testator’s use of words, “income,” “net income,” “issues and profits” and the like, without more specific directions. Norris (1923) 23 Col. L. Rev. 369.

8 The apportionment rule apportions extraordinary cash dividends as well as stock dividends. McKeown’s Estate (1919) 263 Pa. 78, 106 Atl. 189. While apportionment of cash dividends is not discussed, it is believed that it also is objectionable because it is impossible to apply it accurately.

9 “The very purpose of our decision is to make the corpus of the trust fund have exactly the same value after the division of dividends as when the trust was originally created.” Matter of Osborne, supra note 5, at p. 485.

must preserve the value of the corpus unimpaired. Having rejected a vote of the board of directors as binding in these cases, and launching an independent inquiry, the courts apparently turn about, and, in their search for the value of the corpus, accept valuations as determined by the “Treasurer and Vice President,” or fixed in part by a vote of the stockholders. The first cases figured the value of the corpus from the market value of the shares on the day of the testator’s death. It was soon seen that this measure of value was inadequate, and the test in later Pennsylvania cases seems to be “actual value.” In New York we find the courts making findings of “intrinsic value” from the books, records, and reports of the corporation. In a very recent case the court made its finding on the basis of a report of capital and earnings furnished by the executor. Through all of the decisions one is conscious of faulty methods of valuation. To ascertain the value of the corpus the courts must order an independent and complete inventory of assets as of the time of the testator’s death.

11 “The stock was carried by the trustees at a value of $200 per share. It was sold for $415 per share. These prices may be assumed to represent with accuracy the respective values of the stock at the time the trust fund was established, and at the time the stock was sold. The trustees were respectively president and treasurer of the company and necessarily cognizant of the value of its assets, and consequently of its capital stock.” Matter of Schaefer (1917, 1st Dept.) 178 App. Div. 117, 165 N. Y. Supp. 19, aff’d. 222 N. Y. 533, 118 N. E. 1096. “This appears from the uncontradicted testimony of . . . the Treasurer and, . . . Vice President.” Thayer v. Burr (1911) 201 N. Y. 155, 94 N. E. 604. “All of the above findings [of value] were founded upon the uncontradicted testimony of the Treasurer of the Pure Oil Co. . . .” McKeown’s Estate, supra note 8.

It should be noted that the placing of the burden of evidence upon the remainderman to show “value” actually defeats justice since the cost of proving “value” would in many cases be more than the value of the remainder.

13 “The railroad property sold . . . is replaced by the $60,000,000 which was the price at which the stockholders were content to sell, and which must be accepted as the full value of the coal properties sold. There is certainly no proof on the record by which any other value could be arrived at.” Sturgis v. Roche, supra note 10, at p. 785, 204 N. Y. Supp. at p. 864.

14 See Earp’s Appeal, supra note 5.

15 “. . . a judicial decree should go down through the shifting sands of the stock market until it reaches the solid rock of actual value.” Moss’ Appeal (1893) 83 Pa. 264. Stokes’ Estate (1913) 240 Pa. 277, 87 Atl. 971 seems to say that “actual value” and “intrinsic value” are the same, and that “market value” may aid in ascertaining “intrinsic value.”

16 “The intrinsic value of the trust investment is to be ascertained by dividing the capital and surplus of the corporation existing at the time of the creation of the trust by the number of shares outstanding which gives the value of each share.” Matter of Osborne, supra note 5, at p. 485.

17 See In re Bemis’ Will, supra note 10, at p. 372.

18 While it is not assumed that the problem is the same, the experience of the courts and state commissions in “valuing” the assets of public service corporations for purposes of taxation sufficiently illustrates that anything other than a minute inquiry will not disclose real value.
find value of the assets of one of our modern industrial giants, the cost is so great as to render the rule of apportionment impracticable.

Other questions arise. What is value? The economists seem to be in disagreement. Is it the number of dollars represented at the time of the testator’s death, or the purchasing power of that many dollars? In valuing the physical assets, is it what they cost less depreciation up to the beginning of the trust, or is it replacement value? Should the parts be valued at their piece price, or as part of a going concern? All of these questions are left unanswered simply because the courts have not pursued their inquiry to fundamental facts. The decisions, therefore, have been based upon an approximation of “value.” They represent, not apportionment, but a more or less arbitrary allotment of stock dividends, a part to the life tenant, and at times a part to the remainderman.

A further difficulty presents itself when it is attempted to ascertain the present value of the corpus. In valuing a going concern, present value is capitalized expected net annual income. Here, an element of speculation and prophecy enters. The court must assume future income to arrive at present value. Where that value is being used to test whether the original corpus is being preserved, are we not encountering something very like the vicious circle in the rate-making problem?

Out of sympathy for the life tenant the apportionment rule might be condoned were it not for certain other legal consequences which seem to have been entirely overlooked. Valuable legal relations attach to the ownership of stock, and those legal relations have a value which is a part of the value of the corpus. This seems to have been recognized to some extent even in the apportionment states, since there, “rights” to subscribe to additional stock of the corporation go to the remainderman. And even though these “rights” have a “value,” no

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18 In re Bemis’ Will, supra note 10, where the court was called upon to apportion stock dividends of five of the Standard Oil companies; in Sturgis v. Roche, supra note 10, the court had the task of valuing the capital of the Delaware, Lackawanna, and Western Railroad.

19 A further troubling factor was introduced by the decision in Thayer v. Burr, supra note 11, where it was held that any increase by way of appreciation of capital goes to the remainderman. This was affirmed in Matter of Schaefer, supra note 11. Though no rule for distinguishing appreciation of capital from company earnings has been adopted, subsequent decisions take care to recite that they are within that rule.

20 Commons, Legal Foundations of Capitalism (1924) passim. A careful reading of this valuable book is convincing on the point that cursory investigations for the purpose of ascertaining value are futile.

21 Fisher, Purchasing Power of Money (1911) passim; Stabilizing the Dollar (1920) passim.

22 Commons, supra note 20.

23 Commons, op. cit. at p. 157 et seq.


inquiry is made as to whether that is a value resulting from earnings over and above the value of the corpus. Assume this case. The board of directors of a corporation, seeking to secure a firmer hold in the field, distributes normal cash dividends, and transfers the greater portion of remaining surplus earnings to capital, issuing "stock dividends" therefor. As long as the "value of the corpus" is not impaired these stock dividends go to the life tenant. The corporation, despite these precautionary measures, suffers reverses later, and voluntarily or involuntarily liquidates. There is a balance remaining after all creditors are paid, amounting to less than the value of the assets at the time of the creation of the trust. This balance belongs to the stockholders pro rata. The courts, though leaving the corpus "unimpaired" as of the time of the apportionment, have materially reduced the percentage holding of the corpus, and so, the amount due the remainderman upon liquidation. When the testator purchased the stock, he took his risk of loss with the board of directors. The apportionment rule, when it deprives the remainderman of his right to a distribution of assets based upon his original percentage of shares, increases the risk of loss, and actually impairs the value of the corpus. The fairness of the apportionment rule is only theoretical and elusive. Its application is dangerously variable, and it is really unfair to the remainderman. The Supreme Court of Ohio has chosen wisely in its adoption of the Massachusetts rule. The advantage of simplicity is obvious.


26 Baker v. Thompson, supra, "The right to subscribe is an incident of the ownership of stock." Also, Sturgis v. Roche, supra note 10, is interesting in this connection. The directors of the corporation sold its coal lands to a new coal company for $60,000,000. The coal company agreed to give the stockholders of the original corporation, pro rata "rights" to subscribe to stock of the new company at par. The coal lands were the only assets of the new company. These "rights" were worth on the market $23,000,000. The court held that the value of the "rights" could not be deducted from the value of the corpus as a distribution of capital and that the "rights" went to the remainderman—they were not "income" for the life tenant, thus concluding, apparently with no investigation whatever, that this value represented appreciated capital value. In fact, this adds to the conventional classifications—Capital and Earnings, a third, which might well be called Prizes, and Prizes go to the remainderman.

27 Cook, op. cit. supra note 1, sec. 641, and cases there cited.