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THE LEGAL RESPONSIBILITY OF PUBLIC ACCOUNTANTS

Long before actions either for breach of contract or for negligence were permitted, actions for injuries caused by the careless or unskilful performance of undertakings were common. In the typical case the plaintiff, relying on the promise or representation of the defendant or on the skill usual to his calling, permitted the defendant to deal with his person or property. This

permission in the eyes of the law at that ancient day absolved the defendant from responsibility for the results of his act—the dealing with the plaintiff’s person or property. But the permission was given by the plaintiff only in reliance on the false representation of the defendant as to the services to be rendered. Thus the damage was related to the misleading representation of the defendant. The remedy allowed was an action on the case for a misfeasance. Such actions were not for breach of contract: they could not be grounded on a mere nonfeasance, and consideration in its modern sense was no part of the plaintiff’s case. They were closely related to actions for deceit on a warranty of goods—in fact, they were substantially actions on warranty of careful and skillful service. In the same group was the action against a baillee. In all, the gist of the wrong was the misleading of the plaintiff to his harm.

Actions on warranties of goods are nowadays usually regarded as contractual in their nature; but a delictual theory of recovery is frequently insisted upon, the gist of which is still the misleading of the plaintiff. In cases of imperfect performance of service contracts, the action is sometimes treated as sounding in contract, and sometimes as in tort for negligent injury. It is be-

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3 “A person holding himself out to do certain work, implies warranty of his possession of skill reasonably competent for its performance.” 2 Beven, Negligence in Law (3d ed. 1908) 1127.
4 Ames, loc. cit. supra note 1. “... a neglect is a deceit to the bailor. For when he entrusts the baillee upon his undertaking to be careful, he has put a fraud upon the plaintiff by being negligent, his pretence of care being the persuasion that induced the plaintiff to trust him.” Lord Holt, C. J., in Coggs v. Bernard (1703, Q. B.) 2 Ld. Raym. 309, 910. Needless to say Lord Holt does not refer to deceit in the limited sense in which it is now understood. “Deceit” formerly had a much wider significance. “In all those employments where peculiar skill is requisite, if one offers his services, he is understood, as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment and if his pretensions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession.” 2 Cooley, Torts (3d ed. 1906) 1386, 1777.
5 1 Williston, Sales (2d ed. 1924) 369; Carter v. Glass (1830) 44 Mich. 154.
6 “... where the action is not maintainable without pleading or proving the contract—where the gist of the action is the breach of the contract, either by malfeasance or nonfeasance—it is, in substance, whatever may be the form of the pleading, an action on the contract ...” Mitchel, J., in Whitaker v. Collins (1885) 34 Minn. 299, 300, 25 N. W. 632, 633 (action for malpractice); Ward v. St. Vincen’s Hospital (1850, 1st Dept.) 39 App. Div. 624, 57 N. Y. Supp. 784 (contract to provide a skillful nurse); Masters v. Stratton (1846, N. Y. Sup. Ct.) 7 Hill, 101 (contract to operate farm and care for live stock); Cook v. Haggarty (1859) 36 Pa. 67 (the same).
7 For example, an attorney may be sued in tort for negligence in the
lieved that a comparatively small number of modern misperformance cases are cases of proper negligence and that these are the ones that would have supported the old writ of trespass on the case for a misfeasance—those, in other words, where the misfeasance involves an affirmative dealing with the plaintiff's person or property. And even these, it is submitted, are more profitably treated as cases of breach of contract unless the familiar doctrines of negligence are recast to give the fact of contract and its disarming effect on the promisee full operative value. The old misfeasance action had at least the merit—which the modern negligence action has not—of stressing what is the most important element of the situation—the misleading of the plaintiff to his harm.

A recent case, Craig v. Anyon (1925, 1st Dept.) 212 App. Div. 55, 208 N. Y. Supp. 259, presents such a situation. The plaintiffs, stock and commodity brokers, had in their employ one X who is variously described in the opinion as a department head, margin clerk, and head bookkeeper. At the request of certain customers he was authorized by the plaintiffs to carry on trading in commodities on behalf of such customers as long as their margins remained intact. X's trading, it seems, very quickly exhausted these margins; but he continued his speculations, ostensibly on behalf of the customers, during a period of five years thereafter. His losses appeared on plaintiffs' books as credit balances due the brokers with whom X had dealt. Large sums were paid out by the plaintiffs in discharge of such apparent debts, although there were no offsetting charges against customers, no customers being chargeable with these losses. Likewise customers were credited with profits never realized and considerable sums disbursed in reliance on the showing of these accounts. Here again, of course, no offsetting charges were possible since no brokers were responsible to the plaintiffs for such false profits. The defendants, a firm of public accountants, were retained by the plaintiffs over the same five year period to perform quarterly audits. Had the defendants inspected all the plaintiffs' books and checked them against each other, the falsifications would have been discovered and further defalcations prevented. The defendants, however, omitted to inspect certain books, accepting instead statements prepared and offered by the defaulter, purporting to be summaries of the contents of the books not inspected. The plaintiffs knew the audits were not sufficiently thorough to determine the


8 That is to say, cases in which the duty of care exists regardless of contract.
actual standing of the firm, but they were assured by the defendants that the books were properly kept. At the trial two questions were submitted to the jury: (1) Were the defendants negligent? (2) If so, what damages to the plaintiffs resulted proximately and directly therefrom—the amount paid the defendants as compensation for making the audit or the total amounts paid out, as alleged, in reliance thereon? The jury found the defendants negligent and returned a verdict for all the sums disbursed. The court agreed that the defendants were negligent, but held that the only damage proximately resulting was the amount paid as compensation. Both parties appealed. The judgment was affirmed (one judge dissenting) on the grounds (1) that the real cause of the loss was to be found in the fact that the defaulter had been given a free hand to trade for the customers above mentioned, (2) that the plaintiffs acquiesced in the defendants' omissions, (3) that the plaintiffs were guilty of contributory negligence in making payments to brokers and customers without personally determining that the payments were actually due by checking the accounting before each payment, and (4) that the chain of causation was broken by the intervening criminal acts of the employee.

The court quoted with approval opinions to the effect that the action was not one of tort but for breach of contract. Yet throughout, it dealt with the case as it would have dealt with one for negligent injury. The case clearly does not come within the scope of the ancient misfeasance actions, for there is no dealing with the plaintiffs' persons or property; moreover, there is no general duty to use care in speaking or writing. It is, therefore, submitted that no action for harm resulting from a negligent audit could possibly be maintained in the absence of a promise to audit given under circumstances amounting to consideration. In view of this, it seems strange to classify the action as other than contractual. Substantively considered, an imperfect performance is not less a breach of contract or more a tort than total failure to perform. If it be argued that the contract raises a tort duty of careful performance conditional upon the contractor's actually beginning to perform, it is difficult to see why this is not merged

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It is not clear whether the court meant that the plaintiffs relied on the oral representations of X without even looking at the accounts or that the plaintiffs relied on the prima facie showing of each customer's or broker's account without analysis or comparison of one account with the other. If the former, since inspection would have disclosed apparent agreement between the accounts and X's oral representations, failure to inspect cannot be said to have had any causal significance. If the court meant the latter, the plaintiffs, as will be shown, was under no necessity to analyze and compare.


11 Smith, Liability for Negligent Language (1900) 14 Harv. L. Rev.
in the unconditional contract duty of the same tenor. That there would, in a common law state, be a choice of remedy is conceded; but even if the remedy chosen were case for negligent injury, the contract would have to be shown, and, as suggested above, the rules of negligence would have to be given special content to apply properly to the situation.

In the proper negligence case the defendant has done nothing to lead the plaintiff to expect one course of action rather than another. It is obviously otherwise when a contract has been made. The contractor actively induces the contractee to rely on his doing certain things. The essence of contract as distinguished from *nudum pactum* is that the promise is one that it is reasonable to rely upon. After contract, the promisee should be, and is, entitled to put the matter from his mind unless and until he is apprised that there is no intention to perform. Then he "must mitigate damages".

Should a factually imperfect but apparently perfect performance make reliance on perfect performance no longer proper? Should active vigilance by the plaintiff be a condition precedent to recovery for harm consequent upon the defendant's breach? Factually the relations of the parties are changed so that of the two the contractee is now the better circumstanced to discover a default: the services are rendered—the goods are delivered. If the contractor was unwittingly careless or unskilful in his services or unknowingly has delivered defective goods, it is reasonable to require the contractee to prevent harm from ensuing if he can. And so, while he should be entitled to assume performance, if facts pointing to a default come to his attention, he

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12 "Under the contract negligently erroneous statements and imprudent advice become torts, on the same principle that under a warranty an erroneous statement was a deceit by the old common law, without even negligence." Holmes, J., in *Corey v. Eastman* (1896) 166 Mass. 279, 287, 44 N. E. 217, 218. "... wherever there is a contract and something to be done in the course of the employment which is the subject of that contract, if there is a breach of duty in the course of that employment, the plaintiff may recover either in tort or contract." Lord Campbell in *Brown v. Boorman* (1844, H. L.) 11 Cl. & F. 1, 44.

13 Thus where knowledge comes by way of total breach at the date set for performance, the measure of damages to a buyer is the difference between the contract price and the market price at the date and place set for performance. *Schopflocher v. Zimmermann* (1925) 240 N. Y. 597. But where from the nature of the contract the contractee cannot be expected to learn of the breach until long after the date set for performance, the damage is measured as of the date of notice. *Camden Cons. Oil Co. v. Schlens* (1882) 59 Md. 31. Where knowledge comes by way of repudiation before the plaintiff has completed his performance, he can not increase damages by continuing it. *Clark v. Marsiglia* (1845, N. Y. Sup. Ct.) 1 Denio, 317. Prospective inability to perform has occasionally been recog-
should investigate; but if the result of investigation is such as would allay the suspicions of a reasonable man, he should be entitled safely to proceed. Nor should suspicion as to the existence of some fact unrelated to the contractor’s default bar recovery where the suspected fact does not exist and where, in addition, there is nothing to cause suspicion of defendant’s default. However slight the degree of vigilance necessary to discover the defendant’s default, the plaintiff’s failure to exercise it should never, in the absence of suspicious circumstances, bar his recovery for harm consequent upon the breach of contract.

This is an absolutely necessary rule for the law of business relations. Any other rule would have every man minding every other man’s business. Eternal vigilance may be a good rule for primitive communities and one-man businesses, but in a highly organized society one must be permitted to rely on the undertaking of others in ordering his own activity. Otherwise no division of labor, no specialization of function is possible. This rule puts the legal responsibility on him who has the economic function. This is proper since he is the one best circumstanced to fend off harm. The proper discharge of his function protects him from loss and others from injury.

Of course, the contractee may rely only for purposes within

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15 But see (1924) 2 CAMB. L. JOUR. 82.

16 “The plaintiff’s misconduct consisted in a failure to discover by inspection a defect in an article specially made for it. . . . Such a failure might make the plaintiff answerable to its men, but even if its conduct be called want of ordinary care it was induced . . . by the warranty or representations of the defendant.” Holmes, C. J., in Boston W. H. & R. Co. v. Kendall (1901) 178 Mass. 232, 237, 59 N. E. 557. “The plaintiffs owed no duty to the defendants to examine the chain before allowing it to be used by their workmen. The only duty they owed in that respect was to the workmen.” Lord Esher in Mowbray v. Merryweather [1903] 2 Q. B. 640, 644. But see Birdwing v. McCormick H. M. Co. (1906) 183 N. Y. 487, 76 N. E. 611; and cf. MacPherson v. Buick Motor Co. (1916) 217 N. Y. 382, 111 N. E. 1050.

17 The possible loss to the auditor is admittedly great, and the extent of the loss bears no relation to the extent of the breach. He is an insurer against all harm caused, in a legal sense, by his carelessness; but so is every negligent person. See Corbin, Rights and Duties (1923) 33 YALE LAW JOURNAL, 501, 524 et seq. To argue against the imposition of responsibility for consequential harm that it would drive auditors out of business is to argue that because the danger of harm to the contractee is very great, the penalty for carelessness should be very small—an absurd conclusion. The auditor’s remedy is to be careful. He warrants care and skill only, not absolute accuracy of result.
the reasonable contemplation of the contractor.\textsuperscript{18} The conventional purposes of an audit are (1) the detection and prevention of fraud and error and (2) the ascertainment of the actual financial condition and earnings of the enterprise.\textsuperscript{19} It seems clear that it should be a breach of contract ("negligence", misfeasance) as a matter of definite law for an auditor to accept the results of any accounting process without analysis, whether proffered by an ordinary clerk or by an employee manager.\textsuperscript{20} If the objects of an audit are kept in mind, this can not be doubtful. Jury, judge, and appellate justices were in accord as to the misfeasance of the defendants in the instant case, but it should, it seems, have been so ruled as a matter of definite law.

The evidence relied upon to show that the plaintiffs acquiesced in the defendants' misfeasance was the statement of the latter that they could not certify the actual financial condition of the company without making certain calculations which they had omitted. The plaintiffs never objected; but the quarterly audits continued. Clearly the audits had some purpose; and since this evidence rules out the second of the conventional objectives above noted, it makes it more certain that the purpose of these particular audits was the discovery of fraud and error and that the plaintiffs relied on the statements of the defendants that there was neither.

It is matter of common knowledge that in large business enterprises, it is necessary for a proprietor to delegate to employees many functions, some discretionary, which in a smaller business he would discharge himself. The larger the business, the less supervision he can give such employees. It is not ordinarily thought to be bad business practice so to delegate what in a smaller business would be proprietary functions, or to omit personal supervision. Neither is it thought bad business practice to pay bills in the usual course of business on the prima facie showing of accounts. In the nature of the case reliance must be had on the representations of the employees to whom the proprietor has entrusted the keeping of these accounts. But the danger of the situation is apparent. The check the business

\textsuperscript{18} Hadley \textit{v. Baxendale} (1854) 9 Exch. 341.

\textsuperscript{19} 1 Montgomery, \textit{Auditing: Theory and Practice} (1922) 19. "There can be no doubt but that the business public look upon the discovery of fraud as an important object to be attained by an audit. . . ." \textit{Ibid.} at 21.

\textsuperscript{20} The court conceded the misfeasance but cited \textit{In re Kingston Cotton Mill Co. (No. 2)} [1896] 2 Ch. 279, for the proposition that the acceptance of summaries proffered by employee managers is not misfeasance. But in that case there was not, as in the instant case, any certain way of analyzing and checking the summary in question. "The detection of fraud is first in the logical presentation of the objects of an audit, because less experience is required to unearth it. . . ." Montgomery, \textit{op. cit. supra} note 19, at 21.
community has developed is the disinterested third-party expert—the public accountant, or auditor. If this piece of machinery is to be of real value to the business man, he must be legally safe in relying upon it.\footnote{21}

In the instant case the plaintiffs entrusted their dishonest employee with various functions, some discretionary, which, as the event proved, enabled him to effect his dishonest ends. But this entrusting was antecedent to the first audit and each report of the auditors constituted an assurance that to date the entrusting had been justified and that disbursements to date in reliance on the employee's representations had been properly made. Twenty times the auditors made that report. It is not surprising that they induced great faith in the trusted employee, and that very large payments were finally made on the strength of his representations that they were due. Unless the size of the payments or the attendant circumstances were such as should have aroused the plaintiffs' suspicions and such as should have led the plaintiffs to investigate, the auditors are chargeable with the losses, since but for their omissions the losses subsequent to the first audit would not have occurred. Neither intervention in time of the plaintiffs' continued acts in reliance on the dishonest employee nor the intervention of that employee's criminal acts is fatal to the plaintiffs' case, since both were to be anticipated—the former as the plaintiffs' established business practice, the latter as the very thing the contract was made to detect and prevent. It is to be feared that the court took the requirement of proximity between cause and effect to mean proximity in time rather than proximity in contemplation.\footnote{22}

It has been said that the continuation of the plaintiffs' established business practices was to be anticipated; but it must be emphasized that radical departures therefrom were not. The

\footnote{21}It may be argued that the fidelity bond is the proprietor's remedy; but the availability of insurance has not in other fields of the law relieved contractors of their responsibility. Cf. Ocean Accident & Guaranty Corp. v. Hooker Electro-Chemical Co. (1925) 240 N. Y. 37, 147 N. E. 351.

\footnote{22}There is no general principle that the intervening criminal act of a third party always breaks the chain of causation. See forged check cases cited in note 23, \textit{infra}. Also Deane v. Michigan Steel Co. (1896) 69 Ill. App. 106. Recovery of moneys embezzled by employee of plaintiff has been allowed against auditors employed to check plaintiff's cash account where but for their carelessness the embezzlement could not have occurred. Smith v. London Assurance Corp. (1905, 2d Dept.) 109 App. Div. 882, 96 N. Y. Supp. 820; \textit{contra:} City of East Grand Forks v. Stello (1913) 121 Minn. 296, 141 N. W. 181. There is no responsibility for a negligent audit to a stranger to the contract who makes a losing investment in reliance thereon. Landell v. Lybrand (1919) 264 Pa. 406, 107 Atl. 783. But \textit{quaere} where the audit is intended and known to the auditor to be intended for the benefit of a third party? Cf. the responsibility of a title abstractor on similar facts. Anderson v. Spriesterbach (1912) 69 Wash. 393, 125 Pac. 166.
true rule of damages for the instant case is to be discerned in another New York decision, Critten v. Chemical National Bank.\textsuperscript{23} In that case the plaintiff depositor sought to recover the amount of a series of twenty-four checks, forged and presented by one of his employees and paid by the defendant bank in twenty-four separate instances scattered over a period of some two years. During that time the verification of the bi-monthly bank statement was entrusted by the plaintiff to the forger. The forgeries were, of course, not reported to the bank. There was no evidence that the failure to discover and report the forgeries had deprived the bank of opportunity of restitution from the forger on the checks paid prior to the first bi-monthly statement. It was held that the bank could not charge the depositor with such checks unless deprivation of the opportunity for restitution had resulted. As to subsequent checks it was held that the bank might charge the depositor's account therewith unless negligent in making the payments; and negligence seems to have meant payment in the face of facts that would put a reasonable man on inquiry, for the power to charge the depositor was denied on one of the subsequent checks paid in the face of indicia of forgery. Futhermore, the power to charge was denied on all checks subsequent thereto, since but for the bank's omission to get a confirmation of the suspicious check from the depositor, the forgery would have been disclosed to the depositor and the forger dismissed. The court speaks of the depositor's omission to report forgeries as misleading the bank to its prejudice. Absence of notice may be assumed by the bank to mean that reported payments were in fact authorized and that similar payments may safely be made. But there is nothing to mislead the bank into thinking that dissimilar payments or much larger or much more numerous payments may safely be made. Such dissimilarity or disparity in size or number of the checks presented by the forger would be a circumstance to put the bank on inquiry.

So, in the instant case, the auditor was not chargeable with payments made prior to the first audit unless the non-discovery deprived the plaintiffs of the opportunity of obtaining restitution from the defaulting employee. As to payments subsequent to the first audit, each should be considered separately. Unless the disbursements made were much larger than usual or much more numerous than usual or unless there were other circumstances present to put the plaintiffs on inquiry, the auditor should be chargeable. It may be that the fact adverted to in the opinion that there had been in three months an apparent change of posi-

\textsuperscript{23} (1902) 171 N. Y. 219, 63 N. E. 969. Accord: National Dredging Co. v. Farmers' Bank (1908, Del.) 6 Penn. 580, 69 Atl. 607. For other cases and general discussion see Arant, Forged Checks—The Duty of the Depositor to his Bank (1921) 31 Yale Law Journal, 598.
tion of some $500,000 was such a circumstance as demanded inves-
tigation; but in any event this circumstance can not be con-
sidered apart from the fact that twenty assurances by the auditor
had antedated it. And this circumstance has no bearing on the
question of the auditors’ responsibility for earlier payments.

It is believed that the treatment of such cases as this as sound-
ing in tort for negligent injury is to be explained in part as a
survival from the ancient misfeasance cases and in part as mere
“mechanical jurisprudence”. He who contracts to render serv-
ices is bound to exercise the care and skill of the ordinary pru-
dent member of his profession or calling. This looks like “the
care of the reasonably prudent man under the circumstances”
and such it probably is. But the use of this label has led to the
application in many of these cases of the familiar doctrine of con-
tributory negligence, and this is undesirable. “Due care”, to most
minds, lay and legal, carries the concept of active vigilance. This
should not be required of the plaintiff contractee. That “objec-
tive good faith”—the rule here contended for—is in the light of
careful analysis really “due care under the circumstances”, is no
excuse for submitting to the jury, without more, the question of
the contractee’s contributory negligence.2

The jury need the

THE NEW YORK COURT OF APPEALS AND PLEADING

Perhaps a single regret may accompany the passing of com-
mon law pleading:—that there also passed the “special pleader”. This type of lawyer has always been reputed to possess great
ability. At least he had a keen interest in and enthusiasm for the
study of pleading. Now we are met with the seeming paradox
that often the abler the lawyer, the less enthusiasm he has for
pleading problems. An excellent example of this is to be found
in the attitude of the New York Court of Appeals towards code

24 “... the featureless generality, that the defendant was bound to
use such care as a prudent man would do under the circumstances, ought
to be continually giving place to the specific one, that he was bound to
use this or that precaution under these or those circumstances. The stan-
dard which the defendant was bound to come up to was a standard of
specific acts or omissions, with reference to the specific circumstances in
which he found himself. If in the whole department of unintentional
wrongs, the courts arrived at no further utterance than the question of
negligence, and left every case, without rudder or compass, to the jury,
they would simply confess their inability to state a very large part of the
law which they required the defendant to know, and would assert, by im-
plication, that nothing could be learned by experience.” Holmes, The Com-
mmon Law (1881) 111.
pleading. That court has always ranked as one of the ablest tribunals in the country, and the reputation of its present personnel is just as high as at any time in its history. Yet clearly the court has no consistent theory of the function of pleading in the modern judicial system. Its early hostility to the infant code is well known. Thereafter more liberal views intermittently prevailed. But in comparatively recent years there has been a retrogression to ancient technicalities, particularly in the attempted resurrection of distinctions between law and equity. Nevertheless, the passage in 1920 by the legislature of the Civil Practice Act and the attempt of the court to give effect to the more liberal provisions as to joinder of parties in that Act led again to a broadening of some of the pleading concepts held by the court, notably that of the cause of action. Now in its latest pronouncement there has again been a most violent reaction towards the past.

In *Ader v. Blau* (1925) 241 N. Y. 11, the plaintiff, suing to recover damages for the death of his intestate, a young boy, set up two counts: in one, charging that the first defendant had negligently maintained an iron picket fence, upon which the intestate had been injured in a manner causing infection and death; and, in the other, alleging that the intestate, being injured by a picket fence, came to the second defendant as a physician and surgeon for treatment and was so negligently treated by the latter that solely by reason thereof he died. The court held, Cardozo, J., dissenting, that the joinder was improper.

It will be seen that the situation was the not unusual one where the plaintiff was in doubt as to just what the proof at the trial would disclose. He felt that he had a possible claim against either or both of the defendants and he desired to lay the whole case before the court and let it decide. Why is this not socially desirable? Instead of two cases with much of the testimony identical there is only one, and the time of courts, of litigants, and of the witnesses—a most meritorious but little considered class—is saved. The court, however, does not approach the case from this angle. It begins its discussion by saying that if the joinder is permissible, “a step has been taken away from prior rules of practice and procedure which will be regarded as a long and
conspicuous one, even in these times when the desire for procedural reform and improvement has become strong, widespread and fruitful.” After this illuminating disclosure of its emotional reaction to new pleading situations it continues: “Of course, we ought not to be led into taking it even under the alluring desire for progress and improvement if it is forbidden by controlling rules and statutory provisions.” It is submitted that there are no such controlling rules and provisions.

Apparently the court’s difficulty came from the fact that the legislature, in adopting the liberal English rules as to joinder of parties in the Civil Practice Act of 1920, failed to remove the old shackles as to joinder of causes of action. Thus persons may be joined as plaintiffs where “if such persons brought separate actions any common question of law or fact would arise”; persons may be joined as defendants “against whom the right to any relief is alleged to exist, whether jointly, severally, or in the alternative”; and further, a plaintiff in doubt as to the persons from whom he is entitled to redress, may join two or more, “to the intent that the question as to which, if any, of the defendants is liable, and to what extent, may be determined as between the parties.” But causes of action, in order to be joined, must still be “consistent with each other” and must fall within one of the arbitrary classes of the statute, including the famous one of “claims arising out of the same transaction or transactions connected with the same subject of action.” The modern tendency is to do away with those ambiguous restrictions. Yet a liberal interpretation of them, viewing them, and in fact the entire subject of pleading, from the functional standpoint, would make of them usable concepts. The court had previously given occasion

Supp. 784 (two justices dissenting), which in turn had reversed the Special Term.

4 The opportunity thus afforded for confusion was discussed in COMMENTS (1923) 32 YALE LAW JOURNAL, 384.

5 N. Y. C. P. A., 1921, sec. 209.

6 N. Y. C. P. A., 1921, sec. 211; continuing that “judgment may be given against such one or more of the defendants as may be found to be liable, according to their respective liabilities.” Sec. 212 states that it is not necessary that “each defendant shall be interested as to all the relief prayed for, or as to every cause of action included in any proceeding against him.” For joinder of parties alternately responsible, see (1924) 33 YALE LAW JOURNAL, 328, (1925) 35 YALE LAW JOURNAL, 113.

7 N. Y. C. P. A., 1921, sec. 213. The court says: “It is not claimed that section 213 covers this action.” One may be permitted to wonder why. Was it because of the mere form of the complaint? See discussion of the form of the complaint, infra.

8 N. Y. C. P. A., 1921, sec. 258. Many codes do not contain the express requirement of consistency.

9 In England and in some of the states restrictions on joinder of causes have been substantially removed. COMMENTS (1923) 32 YALE LAW JOURNAL, 384; Sunderland, Joiner of Actions (1920) 13 MICH. L. REV. 571.
to hope that such was its point of view. That hope is shattered by the present case. Here the court holds (a)— inferentially—that there are more than one cause of action, (b) that the causes are inconsistent, (c) that they do not arise out of the same transaction or transactions connected with the same subject of action, (d) that—probably—the common question of law or fact test does not apply to the joinder of defendants, (e) that there is no such common question here, and (f) that the defendants are not responsible “jointly, severally, or in the alternative”. With each one of these conclusions the writer disagrees. How should the somewhat vague provisions of the original code be interpreted? The answer should be made only after the function of pleading in the trial of a case is determined. The common law writ system was, as is well known, really a corollary, or perhaps an embodiment, of the substantive law of the time. There was no right without a writ. The pleadings, therefore, worked out in advance of the trial the law of the case. If the plaintiff’s lawyer misinterpreted the law, that was the plaintiff’s misfortune. The plaintiff was expected to foresee the form in which the testimony at the trial would develop, to know the applicable law, and to act accordingly. The procedural reform of the nineteenth century was a reaction against this harsh system. For it was substituted the pleading of the facts. No longer was the plaintiff required to give the exact legal label applicable to his case; he was only expected to give, in advance of the trial, his

10 See supra note 2.

11 This suggestion is contrary to the view ably expressed by Crouch, J., in Sherlock v. Manwaren, supra note 2, and seems contrary to the English experience, where the extension of the privilege of joining plaintiffs has resulted in the decisions in a like extension as to defendants. See Payne v. British Time Recorder Co. [1921, C. A.] 2 K. B. 1; Eng. Ann. Prac. 1924, 224-226; Comments (1923) 32 Yale Law Journal, 384, 386. But see (1924) 24 Col. L. Rev. 681. It is true that the test is expressly stated only in the section on joinder of plaintiffs. But the joinder of defendants is stated substantially without restriction (N. Y. C. P. A., 1921, sec. 211); and hence if the test does not apply, surely a broader, rather than a narrower rule, as intimated by the court, must apply. But the absence of a stated restriction would render applicable the general theory of trial convenience as the controlling test. This principle comes from the equity rules of joinder which were adopted generally by the codifiers. Trial convenience would largely turn on such points as whether the testimony of the witnesses against each defendant separately would overlap; and hence, in substance, we are back to our “common question of law or fact” test, probably as good a statement of the rule as we can make. Furthermore, the defendants must of necessity be those who claim adversely to the plaintiffs and, as the English experience shows, it seems impossible to determine one set of parties without recourse to the methods of determining the other set.

12 In the limited space here available an extended discussion of each point is not possible. It is believed, however, that the writer’s position has been made clear in the articles cited supra.
best idea of how the past happenings which brought him into court had occurred. After the trial had definitely established the facts, the court was to give the proper legal judgment. Furthermore, pleading was to be relegated to the position of an aid to the administration of justice, instead of being an end in itself. And hence we have our modern conception of the function of pleading, with particular emphasis upon its effect on the efficient conduct of court business.

The change in attitude towards joinder of parties illustrates this trend. At common law, joinder was only permissible where the substantive right was viewed as joint, as in the case of joint obligations or joint torts. Joinder as a purely procedural device to act as a short-cut in litigation was not contemplated at common law. It came in, however, from the equity procedure with the adoption of code pleading; and it is now being extended, as witness the Civil Practice Act. Hence it seems curious in the present case to find the court going back to the old rules determining what are joint torts and who are joint tortfeasors to justify its decision.\textsuperscript{13}

If then this functional aspect of pleading is considered, the purpose of the pleadings is no longer to notify the court of the legal labels involved but to give fair notice of the facts considered as the ground of suit, and of as many facts as may be efficiently litigated as a single suit. In the principal case we have the question, how many causes of action are there presented? The court thinks of the legal labels to be applied in deciding the case and says, two, one for the negligence or nuisance of the owner, one for the malpractice of the physician.\textsuperscript{14} Yet the non-legal witnesses are not going to divide up their testimony along those lines. They are there to tell what they know concerning the facts leading to the death of the child. This is the ground or occasion of the suit, and hence, in the practical and lay sense, is the cause of action. Since pleading is to give a foretaste of the facts which in turn come from lay witnesses, and since it is the shortening of trials, rather than instruction of the court in the process of legal labelling which the pleadings are designed to assist, the latter is the proper content for the phrase in this connection.\textsuperscript{15}

Similar principles apply to the other terms considered in the opinion. The court, thinking of the different rights of action against each defendant, holds there is no common question of law

\textsuperscript{13} Cf. (1925) 34 YALE LAW JOURNAL, 335. The discussion was made in connection with the holding that inconsistent causes of action were stated.

\textsuperscript{14} These express labels are used by the dissenting justices below. See supra note 3.

\textsuperscript{15} See Clark, loc. cit. supra note 2. Professor McCaskill, however, believes that a more legalistic definition should be given to the concept cause of action; he, too, favors the lay definition of transaction and transactions connected with the same subject of action. McCaskill, Actions and
and fact; and yet the practical reason for the form in which the suit is brought is that the plaintiff is not sure who caused the death of the child. Likewise the court holds that there is more than one (legal) transaction, and more than one subject of the action, to wit, the separate negligence of each defendant. It is true that this legalistic, rather than lay or practical definition, was the one made in certain early New York cases; but these have been so far neglected in the later cases that their resurrection is unexpected; and they have been definitely repudiated by other courts and in other codes. And finally the same explanation holds of the big bugaboo to the court in the case, the requirement of consistent causes of action. Here is no necessary inconsistency in the facts as the lay witnesses will tell them; there is only an inconsistency of legal theories. Proof of the facts constituting one of the counts will not necessarily show that the other is not true (unless perchance the case is made to turn wholly on the use of the word "solely" in the second count). This is the only true basis of inconsistency, as the courts have come to see, not only in connection with inconsistent causes of action, but also with inconsistent defenses, where the experience has been extensive and decisive. Moreover, under the new provisions the

Causes of Action (1925) 34 Yale Law Journal, 614. See also Comments (1925) 34 Yale Law Journal, 879.


17 The court does not cite authority on this point; it says, "It seems too clear for debate that such contradictory and repugnant theories cannot be consistent and that plaintiff at this point fails to sustain his complaint."

18 The form of the complaint is discussed, infra.


20 See Comments (1921) 1 Or. L. Rev. 26; (1922) 10 Calif. L. Rev. 251; (1917) 1 Minn. L. Rev. 94. As showing the liberal development, cf.
plaintiff may make alternative claims against different defendants. The effect of the court's logic would be to wipe out the statute the provision permitting the suing of defendants alternatively responsible.\footnote{2} By this strict construction the new statute does not amend the old; quite the contrary.

It would seem, therefore, that the plaintiff has shown a proper case for the application of the new provisions as to joining defendants.\footnote{22} True, it would have been more artistic for him to have told his story in numbered paragraphs in a single count and asked the court specifically to determine the responsibility of each defendant.\footnote{2} This would have indicated more directly his reliance on these statutes. Yet in view of the confusion of the New York cases on this matter of the use of separate counts, he ought not to be criticised on the score of form alone.\footnote{22} The main point is that there is no possible doubt of his position, and a rewriting of the complaint could not the more clearly inform the court and counsel that he wishes to hold one or both of the two defendants for the child's death. The case should not even have been reversed for the correction of the pleading, much less for the dropping of one of the defendants.

Had the court contented itself with holding the joinder inconvenient on the facts, comparatively little harm would have been done. But the wording and tone of the opinion must necessarily

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\footnote{2}{See supra note 6. The court has apparently recognized joinder in the alternative in *Zenith Bathing Pavilion, Inc. v. Fair Oaks S. S. Corp.* (1925) 240 N. Y. 307, 118 N. E. 522, citing some of the lower court decisions.}


\footnote{23}{The confusion is discussed in Clark, *loc. cit. supra* note 2. See also *supra* note 15. For example, in the case of *Heapby v. Eidlitz* (1921, 1st Dept.) 197 App. Div. 455, 189 N. Y. Supp. 431, the plaintiff made alternative allegations against the defendant—a practice permissible under the more liberal codes, (1924) 34 *Yale Law Journal*, 103; and the court *per* Page, J., reached the surprising result that there were two causes of action stated which were inconsistent and that therefore they must be separately stated.
have the most baleful effect upon the lower New York courts, most of whom, unfortunately, needed no spur towards pleading legalism. The harm of such a decision is not limited to the particular case; it will continue long after this litigation, now so unnecessarily to be lengthened, has at length been ended. It will continue in fact until it is either overruled by the court or legislature; for that, it is confidently predicted, will be its fate.

C. E. C.

CONTRIBUTION BETWEEN OWNERS OF WRONGFULLY PLEDGED SECURITIES

The cases occasionally present the situation where contribution is exacted from persons subjected to a common burden from which they are freed at the expense of others in the same position; and with the increasing complexity of commercial organization its frequent recurrence may be expected. In the recent New York Case of Asylum of St. Vincent de Paul v. McGuire (1925) 239 N. Y. 375, 146 N. E. 632, several people deposited with a broker negotiable securities for safe-keeping. After wrongfully pledging them with a bank for a loan, the broker became bankrupt and the bank liquidated sufficient securities to recover its loan, the securities of a few, however, remaining intact. Reversing the trial judge, the court held that the remaining securities should be sold and a pro rata division of the proceeds be made among all the depositors.

In the few cases involving this same factual situation the courts have adopted two distinct views: first, that securities surviving the bank’s claim may be recovered in full by their original owners without contribution; and, second, that the remaining securities shall be subject to such contribution as will effect a pro rata distribution of the loss. The instant case represents the application of the second view, and is in accord with the

24 Professor Rothschild, the successful counsel in the instant case, has suggested that it is pressure of business which leads to the illiberal attitude on the part of the lower New York courts. (1925) 25 Col. L. Rev. 30, 41. It may be that the courts do hope to lighten their labors by disposing of the cases before them on short and narrow pleading grounds; but in the long run this can only serve to increase the congestion. Pressure of business ought to lead to less, rather than more, insistence on pleading technicalities.

1 For the duty owed by a broker to his principal, see (1925) 34 Yale Law Journal, 449.


result reached by the courts in several analogous situations. These are well-recognized in the law. In early times it was the custom for the king to take at his own price "a tun of wine before the mast and a tun behind" from every ship carrying wine into a port of England. This was called "prisage of wines"; and those whose wine was spared were made to contribute to the loss of him whose wine was sacrificed, it being thought fairer that the loss arising out of the common liability which by chance had fallen on one should be shared by all. Similarly with the notable doctrine of general average in maritime law, those who benefit when the goods of others are thrown overboard to prevent a vessel's sinking, must contribute to make good the loss. So, where under the will of his ancestor an heir is held to take by descent in order to make him responsible for debts overlooked by the testator, he has a right to contribution.


4 Referred to in I Hen. VIII, 1509, c. 5, sec. 6.

5 "Prisage of wines, mentioned in the statute 1 H. 8, c. 5, is a custom by which the king out of every bark laden with wine under forty tuns, claims to have two tuns at his own price." Rastell, Terms do la Ley (1st Am. ed. 1812) 321. See Deering v. Winchelsea (1800, Exch.) 2 Bos. & P. 270, 273; 1 Hargrave, Tracts (1st ed. 1787) 116 et seq.

6 Deering v. Winchelsea, supra note 5.

7 General average is explained in 5 Viner's Abridgment (2d ed. 1792) Contribution and Average, 561; "1. Average is commonly used by the law merchant for that contribution which merchants and others make towards losses sustained, where goods are cast into the sea, for the safeguard of the ship, or of the other goods, and lives of the persons therein during the tempest; and it is called average and contribution because it is proportional and allotted after the rate of every man's goods aboard. 2. All the parties interested are to bear the loss by a general contribution, and a master or purser of a ship, shall contribute for the preservation thereof; also the passengers, for such things as they have in the ship, be they precious stones, pearls, or the like; and where passengers have no goods in the ship, in regard they are a burden to it, it is said an estimate shall be made of their apparel, rings, jewels, etc., towards a contribution for the loss; and generally money and jewels, clothes, and all things in the ship (except the clothes which are upon a man's body, or victuals, etc. put on shipboard to be spent) are liable to average and contribution; and the goods lost shall be valued, and the goods and merchandise saved are to be estimated, which being known, a proportionable value shall be contributed by the goods saved, towards reparation of the goods cast overboard; and if in the casting over, or lightening of the ship, any of the remaining goods are spoiled, or receive injury, the same must come into the contribution for the damages received. 30. . . . Contribution may not be had in any case but where the ship arrives in safety." The extract from section 30 is suggestive of the analogous situation in the instant case in that there must be some securities surviving the sale by
from the other distributees of the will who, taking by purchase, escaped responsibility for the overlooked debts. Likewise tenants in common must contribute to the expense of discharging an obligation affecting the whole estate and borne by one of them. And where sureties have discharged the surety debt they become subrogated to the principal creditor's claims against their co-sureties, and are entitled to contribution from them.

These analogies indicate clearly the tendency of the courts to apply the principle of pro rata contribution. In them the issue becomes whether or not there is a common bottom, a co-tenancy, a co-suretyship, or any situation involving a common obligation. The instant case presents precisely the same situation, although in a more complex form. By choosing the broker to keep their securities for them, the depositors, though acting independently of each other, vested him with a power to subject their securities to a common obligation; the securities in this case being negotiable, the broker's repledging them was as effective as if he had acted as their common agent chosen by them to do so.

Of all the analogies mentioned, the instant case most closely resembles the suretyship situation. Although it does not con-

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8 Biederman v. Seymour (1841, Ch.) 3 Beav. 368. In Tomlinson v. Bury (1887) 145 Mass. 346, 14 N. E. 137, contribution was required in an analogous situation.

9 "The right to contribution results from the maxim that equality is equity. . . . 'Natural justice says that one surety, having become so with other sureties, shall not have the whole debt thrown upon him by the choice of the creditor, in not resorting to remedies in his power, without having contribution from those who entered into the obligation equally with him. The obligation of co-sureties to contribute to each other is . . . so generally acknowledged that courts of law in modern times have assumed jurisdiction.'" 1 Brandt, Suretyship and Guaranty (3d ed. 1905) sec. 279; Lansdale v. Cox (1828, Ky.) 7 T. B. Mon. 401. Story, op. cit. supra note 7, at sec. 492.

10 "The principle is, that parties having a common interest in a subject-matter shall bear equally any burden affecting it. . . . Equality is equity. One shall not bear a common burden in ease of the rest. Hence, if as often may be done, a lien, charge or burden of any kind, affecting several, is enforced at law against one only, he should receive from the rest what he has paid or discharged on their behalf. This is the doctrine of equitable contribution, resting upon as simple a principle of natural justice as can be put." Eliason v. Eliason (1869) 3 Del. Ch. 260, 263.

11 "The various parties selected a common agent, and this agent used its power to place them all under a common liability, thus virtually making them all sureties for itself." McBride v. Potter-Lovell Co., supra note 3, at 9.
form to the orthodox suretyship, there being no contract,\textsuperscript{12} it is considered to be such by many legal thinkers. Some writers on suretyship make no reference to cases of this nature; but those who do refer to them either imply that it is a suretyship\textsuperscript{14} or openly say so.\textsuperscript{15} It has been recently called a "quasi-suretyship",\textsuperscript{16} a term which may be suitable in view of its combining the undoubted effect of a suretyship with a marked difference in form and manner of arising.\textsuperscript{17} For it appears that the securities themselves are the "sureties" in this case, as the owners entered into no personal obligations or contract of suretyship. Indeed this presents a situation which might accurately be termed an impersonal suretyship.\textsuperscript{19} Nevertheless, whether it

\textsuperscript{13} Cf. "Suretyship is always a matter of agreement between the parties expressed in terms or implied by their conduct or by circumstances. There is no such thing as principal and surety without a contract relation between them expressed or implied." Brandt, \textit{op. cit. supra} note 10, at 7-8.

\textsuperscript{14} Ames, \textit{Cases on Suretyship} (1901) 549, includes the case of \textit{McBride v. Potter-Lovell Co.}, \textit{supra} note 3, thereby considering the case as one involving suretyship, and his footnote to the case expressly treats it as a case of suretyship. Also Stearns, \textit{Cases on Suretyship} (1907) 589 includes the same case under the heading "Contribution between persons in the situation of a suretyship."

\textsuperscript{15} Childs, \textit{Suretyship and Guaranty} (1907) 322, citing \textit{McBride v. Potter-Lovell Co.}, \textit{supra} note 3, says, "Where an agent of various persons pledges the notes of such persons for his debt, the owners of the notes are co-sureties for the agent". And also on p. 333, citing both cases, "If the co-sureties are on different instruments, for different amounts, their equitable share will be proportionate to the amounts called for in the different instruments." Spencer, \textit{Suretyship} (1913) 200, in speaking of \textit{McBride v. Potter-Lovell Co.}, \textit{supra} note 3, says, "Indeed the equitable nature of the doctrine of contribution may be illustrated by reference to a sort of involuntary suretyship, if the term may be permitted. Thus where the common agent of several principals acting in breach of his trust, validly pledged the property or securities of all of them to secure his own debt, it was held that the one whose property was thereby subjected to the discharge of such debt was entitled to contribution from the others in proportion to the value of the several interests so pledged." \textit{Whitlock v. Seaboard National Bank}, \textit{supra} note 3.

\textsuperscript{16} (1924) 22 Mich. L. Rev. 617-618. "The instant case is novel in that all of the parties were induced to buy shares through the fraud of the corporation and therefore if any co-suretyship relation existed, it did not exist by any contract either expressed or implied. . . . In consideration of these equitable principles, the court of chancery has seen fit to give contribution in many cases where it would be hard to make out a co-suretyship relation in the strict orthodox sense".

\textsuperscript{17} A suretyship usually involves a contract between the principal and the sureties and is voluntarily assumed. In the present case there is no contract involving personal obligations, and the jeopardy of the securities was involuntarily imposed.

\textsuperscript{18} Ames, \textit{Cases on Suretyship}, loc. cit. \textit{supra} note 14, in note to \textit{McBride v. Potter-Lovell Co.}, \textit{supra} note 3, "The doctrine of the principal case applies equally although the co-suretyship created against the will of the parties be real and not personal, as in \textit{Gould v. Central Trust Co.}, \textit{supra}
is called a quasi-suretyship or an impersonal suretyship, it has the vital elements of a suretyship and the rule requiring contribution among co-sureties should apply.

The chief cause of the conflict in these cases has been the courts' failure to observe this similarity. The first view taken by the courts has an obvious and momentary appeal, inasmuch as the original owners of the securities which are left did not permit the repledge by the broker; indeed, such act was "practically a larceny". But to support their contention that the securities are theirs, freed of all other claims, is to assume the question in point and to ignore the negotiable character of the securities. The bank by selling all the securities to satisfy its loan may extinguish the rights of all the original owners. This indicates that under the first view it is a gamble as to who will stand the loss when part of the securities are sufficient to discharge the bank's claim. Then if the securities are time notes which the bank cashes in their order of coming due, the accident of maturity is the only virtue of those whose notes survive. Also, it would be possible for one of the original owners to prevail upon the bank to reserve his securities until the last, thus allowing the bank to show favoritism, as, indeed, was attempted in the instant case.

An additional factor seems to make the soundness of the second view conclusive. If before any of the securities had been sold any one of the original owners had applied for a marshalling of the securities to discharge the bank's claim and for a pro rata distribution of the balance, he could probably have secured such aid. A precedent on this exact point is lacking; but there are several dicta, and the tendency of authority on marshalling of

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19 See supra note 2.

20 In re McIntyre (1910, C. C. A. 2d) 181 Fed. 956; see also supra note 1.

21 "The notes were all pledged to secure the same indebtedness. The fact that some of them fell due at earlier dates than others creates no equity in favor of those which fell due last." McBride v. Potter-Lovell Co., supra note 3, at 9. Cf. Trust Co. v. Northwestern Guaranty Loan Co. (1896) 166 Mass. 337, 44 N. E. 340.

22 Cf. "The doctrine [of view two] is also justifiable in view of the fact that the opposite rule would make it easy for the creditor to collude with one surety in fraud of the other." (1924) 22 Mich. L. Rev. 617, 618.

23 Cf. Gould v. Central Trust Co., supra note 3, at 386. "We suppose that no one will doubt that if the situation of all of these wrongfully pledged securities had been discovered before the sale of any of them, and the owner of one lot had brought an action in equity to have them marshalled and applied pro rata to the payment of the indebtedness for
Thus, since the equities of the parties are equal before the sale by the bank, indeed from the moment when the broker wrongfully subjects them to a common jeopardy, it is difficult to see why their equities do not remain equal after the bank has sold part of the securities, and why they should not obtain a sale of the remainder and a pro rata distribution of the proceeds.

A third view, with which the court in the instant case attempted to reconcile its decision, has been developed in this situation. In a case adopting this third view the broker held three classes of securities, some as collateral for a loan, some bought on margin for his customers, and the rest merely for safe-keeping, the last of these surviving the sale by the bank. In returning these intact to their former owners and refusing contribution, the court held that those who had owned the securities outright had equities superior to the others, and the court in the instant case stated that since these securities were of different kinds, this conclusion was not contrary to the present holding.

The soundness of this reasoning is not apparent. It is difficult to see why the individual relations between the separate depositors and the brokers should have any effect on the depositors' relations among themselves. To stress the relations between the depositors and the broker is as if, in the prisage or general average case, the payment or non-payment of freight to the captain were allowed to affect the respective equities of the parties; or as if, in the case of the heir, the fact that his ancestor while living had made an advancement to him; or, in the suretyship case, the fact that some and not others of the sureties had owed money to the assured were made operative. Such arguments to avoid contribution in these cases would obviously be of no importance, except as they might affect the proportion of the loss each one has to contribute. The important facts are the common jeopardy of the securities of all the depositors and the free-

which they were pledged, such prayer for relief would have been granted. Such relief would have been based on obvious principles of equity and justice and it seems to us quite inconceivable that the application of those principles is curtailed or destroyed because before the request for equality of treatment is made the pledgee, as a matter of chance, has reached out and taken securities of one holder for sale and left those of another intact. Asylum of St. Vincent de Paul v. McGuirc, cited in text p. 92, at 382, 146 N. E. at 634.

24 See 2 Story, Equity Jurisprudence (14th ed. 1918) sec. 853 et seq. and cases cited.


26 Thus if A bought stock on margin paying ten per cent down, his share of the balance after the bank's claim was discharged would be ten
ing of some of them from that jeopardy by a sacrifice on the part of the others. The resulting increase in the value of the property interest of those depositors whose securities have survived constitutes an unjust enrichment which requires contribution to those at whose expense it was created.

FURTHER DEVELOPMENTS AS TO THE EFFECT OF SOVIET DECREES

One of the results of the growing practice of withholding political recognition from de facto governments is seen in Russian Reinsurance Company v. Stoddard (1925) 240 N. Y. 149, 147 N. E. 703, in which the New York Court of Appeals was called upon to decide how much effect it would give to decrees of the Soviet government. The plaintiff was a Russian insurance company incorporated under the Czar. In 1906, to protect its policy holders and creditors in the United States, it had deposited money and securities in trust with the Mercantile Trust Company which later was merged with the defendant company. In 1918, the Soviet government issued a series of decrees purporting to nationalize and liquidate all Russian insurance companies and to confiscate their property. These edicts also forbade all activity in Russia on the part of the stockholders or directors. When the plaintiff's last insurance policy in New York expired, the directors of the corporation met in France and directed their agent to sue for the deposit. Recovery was contested on the ground that, as a result of the confiscatory decrees, either the Soviet government or the stockholders of the corporation might later claim the deposit. The trial court dismissed the action. The Appellate Division assumed that the law of Russia, that is, per cent of their value. Likewise if B gave securities as collateral for a loan of half their value, his share would be fifty per cent; and if C gave securities to the broker for safe-keeping, on which the broker had no claim at all, his share would be one hundred per cent.

1 For examples, see Fraenkel, Juristic Status of Foreign States (1925) 25 Col. L. Rev. 544.

2 The fund was established to comply with a statute making such a deposit a prerequisite to doing fire insurance business in the state. N. Y. Cons. Laws, 1923, ch. 30, sec. 27. The suit was brought not only against the Bankers' Trust Company which held the deposit, but necessarily against Stoddard, state superintendent of insurance, since his sanction to the withdrawal of the trust fund was required by statute. In addition, he was interested because in certain situations which probably included the instant case, he was given the power to take possession of the property and conserve the assets of foreign corporations. N. Y. Cons. Laws, 1923, ch. 30, sec. 63, subd. 4.

3 For the contents of the directors' resolution and the circumstances surrounding its passage, see the opinion of the Appellate Division in Russian Reinsurance Co. v. Stoddard (1925, 3d Dept.) 211 App. Div. 132, 136, 207 N. Y. Supp. 574, 579.
the Russian "sovereign", under which the rights of the parties were to be determined, was the law of the last regime recognized by our State Department. Under that law the plaintiff was an existing corporation and hence was allowed to recover.

The result of this lower court decision was to give no effect to the acts of foreign governments prior to political recognition and was merely another way of stating that no effect will be given to the acts of an unrecognized government, a doctrine followed in several recent cases arising out of the non-recognition of Russia. The theory of the case, however, is based clearly on a misconception of the term "sovereignty": that the "sovereign" government is that government which has received political recognition. This misconception is, it seems, a result of our State Department's former policy of extending political recognition to each newly constituted authority as soon as it actually obtained obedience within its territories; or, in other words, every "sovereign" government. Under that policy, it is evident, recognition and the advent of sovereignty were practically concurrent in point of time. It was not unnatural, therefore, that there should arise the mistaken notion that sovereignty does not exist until recognition is extended. The distinction is clear, however, under the present policy of the executive department. To-day by the concept "political recognition" our State Department seems to mean not only a recognition of "sovereignty", but also, to a certain extent, approval of the actions and doctrines of the new regime. For the correct concept of a sovereignty is thus presented in Baty, So-called 'De Facto' Recognition (1922) 31 Yale Law Journal, 469: "Is there in any given tract of country, an authority in fact obeyed throughout that area, and not threatened in the field by any real efforts of subjugation —then that district is a state, and the authority is its sovereign". For a seeming confusion of the concepts of "sovereign" government and "politically-recognized" government, see Notes (1925) 38 Harvard Law Review, 816, 819.

4 New York law was actually applied, however, under the rule that "unless it be shown that the Russian law is contrary to the law of the state of New York, this court will apply our own law". Russian Reinsurance Co. v. Stoddard, supra note 3, at 142, 207 N. Y. Supp., at 584.


7 See example in 1 Moore, International Law Digest (1906) 137.

8 The correct concept of a sovereignty is thus presented in Baty, So-called 'De Facto' Recognition (1922) 31 Yale Law Journal, 469: "Is there in any given tract of country, an authority in fact obeyed throughout that area, and not threatened in the field by any real efforts of subjugation —then that district is a state, and the authority is its sovereign". For a seeming confusion of the concepts of "sovereign" government and "politically-recognized" government, see Notes (1925) 38 Harvard Law Review, 816, 819.

9 Baty, op. cit. supra note 8, at 470, condemns such a theory of recognition: "It is impossible to recognize a fact conditionally. Either it is a fact or it is not. The very essence of recognition is that the recognizing..."
Accordingly, as in the case of Russia, recognition may be withheld from an admittedly de facto government. And the courts, including the Appellate Division in the principal case, which purported to apply the law of the "sovereign" can hardly make it depend upon political recognition. Where they have done so, they have had to ignore important economic and social facts and their consequences. For example, the administratrix appointed by an unrecognized regime to settle a private estate was given no standing in our courts. In the principal case it meant that the court was obliged to ignore that the Soviet decree had made the plaintiff corporation non-existent and the directors unable to function legally in Russia and in the many countries recognizing the Soviet regime.

If, however, the error in the reasoning of the Appellate Division be eliminated, and the law of the actual ruling government of Russia be preferred over the law of the defunct Kerensky government, full effect ought to be given to the Soviet decrees. Since the laws of recognized governments are not given effect when contrary to the public policy of the United States, then certainly a similar limitation should be placed on the decrees of the unrecognized governments. But this doctrine, though limited, would hardly bring about a desirable result; for "public state thereby declares that it has satisfied itself that the recognized authority possesses the distinguishing marks of a state. . . . To say that one recognizes that it has them, subject to its conduct being satisfactory in other particulars is sheer nonsense. It is like telling a pupil that her sum is right if she will promise to be a good girl". However, Mr. Baty gives an example from United States history of this view of recognition which he condemns.

10 When the Kerensky ambassador ceased to function in his official capacity at Washington, the status of the attaché who remained was not considered to be changed. Russian Government v. Lehigh Valley Ry. (1923, S. D. N. Y.) 293 Fed. 135 and 137, quoting a letter from Mr. Charles E. Hughes, then Secretary of State. For cases which go on the assumption that our government still recognizes the Kerensky regime as the "sovereign" see The Penza (1921, S. D. N. Y.) 277 Fed. 91; The Rogday (1920, N. D. Calif.) 279 Fed. 130.

11 The State Department may indicate that a de facto government exists without extending political recognition, and thus relieve the courts from having to decide a political question. In the case of Russia, for example, the State Department recognizes that the Soviet regime is a de facto government when it speaks of "the regime now functioning in Russia" (see Russian Government v. Lehigh Valley Ry. supra note 10, at 137); and the courts have followed the State Department's lead. Sokoloff v. National City Bank (1923, Sup. Ct. Spec. T.) 120 Misc. 252, 257, 199 N. Y. Supp. 855, 359.


13 This limitation is applied even in giving effect to the laws of other states of the Union. Texas Ry. v. Richards (1887) 68 Tex. 375, 4 S. W. 627.
policy" as used with reference to the laws of a recognized government, refers only to the mores of our country, and does not consider "recognition" as a weapon of our foreign policy. To apply the principle to Russia, for example, would take away many of the political and economic disadvantages now suffered by the Soviet regime because of its refusal to accept terms upon which the United States would extend recognition. And recognition, instead of being the powerful political weapon into which it has developed, would sink into insignificance.

The Court of Appeals, however, in reversing the Appellate Division, took a middle ground. Apparently realizing that the factual situation in Russia had, at the very least, made the plaintiff's rights in the trust fund uncertain, it held, Judge Crane dissenting, that while it did not recognize the Soviet "as entitled to recognition as a state or government", yet "justice and common sense" required it to "give effect to the conditions existing in Russia" to the extent that the court would not assume jurisdiction. The result seems commendable. The theory underlying the decision, suggested by Judge Cardozo in Sokoloff v. National City Bank, is that the actions of an unrecognized government should not be given effect unless "public policy and justice" demand it. "Public policy" here does not seem to be used in its more limited sense. The principle laid down is apparently that our courts should give effect to all acts of unrecognized de facto governments which are not contrary to our mores and which do not materially weaken our foreign policy.

The roots of this theory are to be found in earlier cases where, as in the instant case, the United States was unwilling to extend recognition to a de facto government. During the War of 1812 the problem came up as to the effect of decrees of the British regime in captured American ports. After the Civil War, many questions arose as to the validity of acts done under laws of the

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25 The refusal was "until the time comes when a government which we recognize rules the country of the plaintiff's domicile, or at least until the plaintiff corporation is able to re-establish its existence in that domicile and the machinery provided by its charter for the management of its affairs is again functioning". The ground on which the court directly based its refusal to assume jurisdiction was that it could not protect the defendant trustees from the possibility of a second suit in a foreign country which recognizes the Soviet government and in which the defendant has assets which could be attached. This possibility is called "very remote" in the dissenting opinion. The court of such foreign government might find itself in a dilemma; on the one hand it would be tempted to give effect to the Soviet decree, and on the other to honor the United States judgment.
26 See Fraenkel, op. cit. supra note 1, at 566.
Confederate States.19 And, in the Philippines, when native governments temporarily took control away from United States authorities, at least one court was called upon to decide what effect should be given to the acts of the insurgent officials.20 The courts in these cases followed almost the same theory as that advanced in the Sokoloff case. It was, however, stated in the positive form that effect will be given to the acts of unrecognized governments unless public policy and justice require otherwise, and the following acts were given effect:21 sale of property,22 levy of customs taxes,23 creation of a corporation for domestic business,21 confiscation of domestic property,25 payment of debts in the specie of the regime,26 and all acts necessary to peace and good order among citizens, such as sanctioning and protecting marriage, determining laws of descent, regulating conveyance and transfer of property, real and personal, and providing remedies for injuries to persons and estates.27 The Civil War cases, on the other hand, do not give examples of acts which, under the theory of the Sokoloff case, should not be recognized because opposed to "public policy and justice". But cases involving the present Russian regime have decided that being unrecognized, it cannot sue in our courts;28 that it cannot have effect given to its decrees of "dissolution" of foreign corporations;29 and that it cannot be sued.30

19 See cases in notes 22, 24, 26, 27, infra.
21 Discussions of these cases and conclusions as to their soundness are found in Connick, Effect of Soviet Decrees in American Courts (1925) 34 Yale Law Journal, 499; Dickinson, Unrecognized Governments (1924) 22 Mich. L. Rev. 29, 118.
22 Thorington v. Smith (1868, U. S.) 8 Wall. 1.
23 United States v. Rice, supra note 18; McLeod v. United States, supra note 20.
24 United States v. Insurance Companies (1874, U. S.) 22 Wall. 99.
28 Russian Government v. Cibrario (1923) 235 N. Y. 255, 139 N. E. 259. For a criticism of the idea that power to sue should depend upon political recognition, see Comments (1923) 31 Yale Law Journal, 534. To allow an unrecognized government to sue, it would seem, in the great majority of cases would involve trespassing on the political field. The Cibrario case, supra, shows how many different aspects of the case must be weighed by the judge, and consequently how vague and difficult to locate is the line of "public policy and justice".
If it be suggested that the courts are not logical in refusing to allow the regime to sue while at the same time they give effect to some of its acts, it may be answered that more than logic enters into the problem. Nevertheless there is a weakness in the theory apparently advanced by the Court of Appeals. For it is clear at once that to the judges is given the task of deciding (1) whether a "regime" is actually de facto and (2) whether our foreign policy has been materially weakened; and both of these decisions belong primarily to the executive department. Though dissatisfaction with the recognition policy of the State Department may prejudice decisions, the doctrine of the instant case seems the most workable one if applied with the realization that "where there is danger of embarrassing the political department, the court should be conservative".

At first thought, the refusal of the court to assume jurisdiction would seem to imply that if the Soviet regime obtains recognition, the trust fund would go to it, under the rule that political recognition makes valid the previous acts of the government recognized. In England, a court decision has prevented such a result, and a late decision of the New York Court of Appeals indicates that this result would also be prevented in the United States. In the instant case the court was careful to point out

Nankivel v. Omsk All-Russian Government (1923) 237 N. Y. 150, 142 N. E. 569; Underhill v. Hernandez (1897) 163 U. S. 250, 18 Sup. Ct. 83. In an English case decided prior to Great Britain's recognition of Russia, action was allowed against agents of the Soviet government who brought goods which had been confiscated at the plaintiff's expense within the territorial jurisdiction of the court. Luther v. Sagor [1921] 1 K. B. 455. The case was later reversed because recognition had been granted, with a dictum to the effect that the first judgment was correct on the facts. Luther v. Sagor [1921, C. A.] 3 K. B. 532. If no property of the unrecognized government was subject to attachment, however, proceedings would be seemingly futile.

31 Dickinson, op. cit. supra note 21, at 133.
32 Oetjen v. Central Leather Co., supra note 5; Biaud v. American Metal Co. (1916) 246 U. S. 304, 33 Sup. Ct. 312. Under the rule the court is called upon to decide the political question of when the de facto government came into existence, i. e., the date from which its decrees will be recognized. But see the Appellate Division opinion in the principal case, supra note 3, at 141, 207 N. Y. Supp. at 583: "We cannot even contemplate that recognition of that (Soviet) government would have such relation back . . . in view of the rule that public policy must always prevail over comity". Russian Republic v. Cibrario 225 N. Y. 255, 263, 139 N. E. 259, 262.
33 Russian Commercial Bank v. Comptoir d'Escompte de Mulhouse [1925 H. L.] A. C. 112. But whether the English court correctly interpreted the law of Soviet Russia has been questioned by M. Rakowsky, Soviet delegate in London. (1924) 5 Russian Information and Review, No. 5.
34 Joint Stock Company of Volgakama Oil and Chemical Factory v. National City Bank (1925) 240 N. Y. 363. The opinion states that the Soviet decrees of nationalization did not dissolve the plaintiff company; that an express or necessarily implied intent to terminate the plaintiff's existence
that the responsibility for making all Soviet actions valid would be upon the State Department, and suggests that unconditional recognition is not the only road open to executive officials. A treaty to be required as a condition precedent to political recognition could well settle the status of foreign branches of corporations which Soviet Russia has decreed to be nationalized. Such a treaty seems not at all unlikely.

must be shown. "We need not go so far" as the Mulhouse case, supra note 33, the court stated, but that opinion is quoted. Crane J., who wrote the opinion repeated his view that no effect whatever be given to the acts of an unrecognized government, but the majority of the court decided that their interpretation of the decrees made consideration of that question unnecessary.