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LETTERS OF CREDIT—NEGOTIABLE INSTRUMENTS

The commercial letter of credit, viewed as a piece of financial machinery, has functioned very satisfactorily. Notwithstanding its long and extensive use, it has occasioned relatively little litigation. This may be ascribed in part to the well defined business and banking understanding of the rights and duties growing out of a letter of credit and also to the fact that houses handling such transactions have little desire to litigate questions of law,

however interesting theoretically. Owing to the unsettled conditions existing during and immediately following the War, however, recourse has been had to the courts in many cases. As a consequence, within the last decade, American courts, notably those of New York and Massachusetts, have been called upon to write much letter of credit law. The major provisions have been well drafted. There remain a number of important sections to adopt.

The ordinary irrevocable documentary import credit, in its simplest form, represents a transaction between three principal parties: buyer, the applicant for the credit and prospective indemnitor of the bank; bank, the opener of the credit; and seller, the beneficiary of the credit. The orthodox legal view has been that this sets up three separate and distinct contracts, though of course all relating to the same transaction. These are the seller-buyer sales contract, the seller-bank payment contract, and the buyer-bank reimbursement contract. That these are distinct and give rise to independent sets of legal relations is apparent when it is considered that the bank may not refuse performance, for example, on the ground that the buyer has failed to carry out the buyer-bank contract.[1] Nor may the bank refuse payment on the ground that the seller has improperly performed the seller-buyer contract.[2] Likewise, even though the bank has paid against an improper shipment, if the documents presented to it by the seller complied with the terms of the credit, it is entitled to reimbursement from the buyer on the buyer-bank contract.[3] To this extent, the independence and enforceability of these contracts is clearly borne out by the decisions.[4] The difficulty has been to reconcile these results with the rest of our law and to provide a theory which will enable a court to decide, on common law principles and at the same time in consonance with business custom, certain other cases which may be expected to arise. The troublesome points are (1) to find consideration for the bank's undertaking, and (2) to make this undertaking ir-

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[1] American Steel Co. v. Irving National Bank, 266 Fed. 41 (C. C. A. 2d, 1920); *cf.* Russell v. Wiggin, 2 Story, 213, Fed. Cas. No. 12, 165 (1842).

[2] O'Meara v. National Park Bank of New York, 239 N. Y. 386, 146 N. E. 636 (1925); (1925) 34 YALE LAW JOURNAL, 775.

[3] Laudisi v. American Exchange Nat'l Bank, 239 N. Y. 234, 146 N. E. 347 (1924); Frey and Son v. Sherburne, 193 App. Div. 849, 184 N. Y. Supp. 661 (1st Dept. 1920).

[4] Bank of Plant City v. Canal-Commercial Trust & Savings Bank, 270 Fed. 477 (C. C. A. 5th, 1921); International Banking Corporation v. Irving National Bank, 274 Fed. 122 (S. D. N. Y. 1921); Bank of America v. Whitney Nat'l Bank, 291 Fed. 929 (C. C. A. 5th, 1923); Lamborn v. Lake Shore Banking & Trust Co., 196 App. Div. 504, 188 N. Y. Supp. 162 (1st Dept. 1921); Bank of Taiwan v. Gorgas-Pierie Mfg. Co., 273 Fed. 660 (C. C. A. 3d, 1921).

revocable, in accordance with its terms, from the moment it is issued.[5]

In the recent case of *Second National Bank v. Samuel & Sons*, 12 Fed. (2d) 963 (C. C. A. 2d, 1926) the court was asked to decide whether a bank, which had discounted for a seller a draft drawn under an irrevocable credit, but which due to delay in the mail had not been presented to the bank issuing the credit until the day after the expiry date of the credit, had any rights against the buyer. The only documents called for by the credit were the invoices of sale, the buyer apparently having taken delivery of the goods. The issuing bank refused to honor the draft owing to the late presentment, and the buyer on its part refused to consent to late payment. The court viewed the letter of credit as being in the nature of a negotiable instrument and reasoned that if a presentment of a bill or note may in some cases be sufficient to charge secondary parties, though made after the maturity date, the same should apply to letters of credit. It then interpreted the buyer's refusal to authorize payment as an act inducing a breach of contract, and held that the buyer, as a tort-feasor, should be responsible in indebitatus assumpsit. This, of course, involved holding that the credit did not expire as its terms provided, but at some indefinite time thereafter, a result opposed to the banking notion of limited term credits,[6] and not supported by authority.[7]

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[5] For a discussion of the various common law theories advanced to explain the letter of credit cases see McCurdy, *Commercial Letters of Credit* (1922) 35 HARV. L. REV. 539; Mead, *Documentary Letters of Credit* (1922) 22 COL. L. REV. 297; (1925) 34 YALE LAW JOURNAL, 775. These writers agree that various theories which have been suggested (*i.e.*, that the bank may not revoke because of estoppel, that the contract between bank and buyer is one for the benefit of a third party, the seller, and that the transaction constitutes a continuing offer on the part of the bank) are all unsatisfactory, although any one of them might appear to be applicable in a particular case. But the theory they consider most applicable—that the bank-seller arrangement is a bilateral contract supported by consideration moving from the buyer—is likewise obviously unsatisfactory if the contract is to be held not only enforceable but irrevocable notwithstanding the bank may have received no consideration from the buyer. For instance, in case the buyer's application is signed by an unauthorized agent, should not the credit still be enforceable by a bona fide seller?

[6] Such a holding injects an element of uncertainty into the situation which, if it were to become settled law, would be economically unfortunate. From the standpoint of both bank and buyer it is desirable that a definite fixed date should be reached at which accounts may be adjusted. If credits were to remain contingent liabilities (in the accounting sense) after their expiry date, either the bank would have to charge a higher rate on new transactions between bank and buyer or otherwise limit credit facilities available to the buyer. From the practice standpoint, it would be extremely difficult in any given case to determine whether payment should be made or not.

[7] The rule that the bank's undertaking will be construed with great

While it is difficult to approve of the particular application of negotiable instrument law made by the court to this case,[8] the proposition that a letter of credit partakes of the nature of a negotiable instrument may be helpful in resolving some of the difficulties now faced by the courts. In order to be useful, however, the points of similarity and difference must be clearly stated. Obviously a letter of credit is more nearly analogous to a bill of exchange than to a promissory note. Suppose, then, that in the instant case, the arrangement had been that the buyer should effect payment by his draft upon the bank in favor of the seller. Add the particular that the bank should accept conditionally,[9] payment to be made against presentation of invoice on or before the specified date. In such a case the rights and duties of the three parties would be very similar to those they would come under, as understood by the business world, were a letter of credit in similar terms used.[10] The principal difference is that made apparent in the instant case, namely that there would be no evidence of any obligation on the part of the buyer to the seller or to any subsequent party.

What the actual evolution of letters of credit may have been has apparently never been satisfactorily investigated.[11] That

strictness when the question is one regarding the sufficiency of documents presented under the credit is supported by all of the letter of credit cases, and, if applied in deciding a question as to whether a presentment after the expiry date is sufficient, would preclude any possibility of holding as the instant court did. Further, as the bank's obligation to the seller is normally in the nature of a suretyship obligation on behalf of the buyer, all of the cases to the effect that a surety's contract will be strictly construed should apply. Such may be the relation as between bank and buyer. *Cf.* Border Nat'l Bank v. American Nat'l Bank, 282 Fed. 73 (C. C. A. 5th, 1922). Obligations of a guarantor which are limited as to time will be construed strictly. *Cf.* Solomon v. Waterbury Brass Goods Corporation, 6 Fed. (2d) 990 (C. C. A. 2d, 1925).

[8] The obvious course would have been to have denied the discounting bank any recovery against the buyer, leaving it to recover from the seller on the seller's obligation as drawer. In such a case the principle relied upon by the court might have applied so that the presentment, though late, would have been sufficient to charge the drawer. If, however, the drawer were to fail or to draw without recourse, the question of whether the discounting bank had any rights against the buyer would become important.

[9] Such an acceptance would no doubt be binding according to its terms. See Mason v. Hunt, 1 Douglas, 296, at 297 (K. B. 1779). No cases involving a similar conditional acceptance have been found where the acceptor has been held responsible on a presentation after the expiry date.

[10] This comparison appears more clearly if one views as a single instrument the buyer's application for the credit (considered as a drawing) and the bank's issuance of the letter of credit (considered as an acceptance).

[11] There have been many references both by courts and writers to the similarity between letters of credit and bills and notes but no analysis of the supposed similarity appears to have been made. For instance it is said: "Letters of credit are instruments of frequent use in commerce, and while not possessing all the characteristics of negotiability which pertain

they are as ancient as bills of exchange, and were developed by the same class, the early merchants doing international trade, is well established. They may be used to serve almost identical functions as above indicated although, of course, drafts conditionally accepted would not meet the requirements of foreign commerce.[12] This is evident when it is considered that the ordinary credit may extend for a period of months and allow of many shipments, the exact amount of which cannot be ascertained in advance. Whether a letter of credit may be recognized by our courts as a species of mercantile specialty[13] in many ways analogous to bills of exchange may well be doubted.[14] On the other hand, the effort of both courts and writers to reach the same end on common law principles is striking. But, if common law principles are to be warped to this end, it seems probable that on many points the law of bills of exchange may well serve as a pattern.

In present practice the fact that the seller draws on the bank under the credit tends to obscure the analogy suggested, that is, that the seller is in the position of payee on the credit itself, if

to bills and notes, partake of them to such an extent as to be necessarily classed as negotiable instruments." 2 DANIEL, NEGOTIABLE INSTRUMENTS (6th ed. 1914) §§ 1790-1800.

To meet the argument of want of privity between one who had discounted drafts drawn under a credit and the issuer, it has been said by Story, J., "I have understood, and always supposed, that, in the commercial world, letters of credit of this character, were treated as in the nature of negotiable instruments; and that the party giving such a letter, held himself out to all persons who should advance money on bills drawn under the same, and upon the faith thereof, as contracting with them an obligation to accept and pay the bills." See Russell v. Wiggin, *supra* note 1, at 230.

[12] Marginal credits were at one time issued in England, the distinguishing feature being that the credit instrument was attached to a blank draft to be filled up and signed by the beneficiary. *Cf.* Maitland v. The Chartered Mercantile Bank, 38 L. J. Ch. (N. S.) 363 (1869).

[13] It is submitted that the essential elements of a letter of credit have long been sufficiently definite to allow of its being treated as a specialty. The discussion in the last few years concerning uniform forms has dealt, for the most part, with questions of terminology as, for example, whether the term bills of lading should refer to "on board" bills or "received for shipment" bills, or whether "policies" of insurance include "certificates." See, WARD, AMERICAN COMMERCIAL CREDITS (1922) 102 *et seq.* But whether letters of credit fully measure up to the definition of a mercantile specialty or not, there is every reason why a court today should, nevertheless, treat it as though it were a specialty similar in many ways to a bill of exchange.

[14] To a limited extent, and by apparently applying common law principles, the courts are already according letters of credit a particular status. It, of course, is not suggested that they should hold that letters of credit may in fact be negotiable instruments governed in all particulars by the negotiable instruments law. On this point the decision of the New York Court of Appeals regarding the negotiability of *interim* certificates is instructive. President and Directors of Manhattan Co. v. Morgan, 242 N. Y. 38, 150 N. E. 594 (1926); (1926) 35 YALE LAW JOURNAL, 877.

the latter be regarded as a bill of exchange.[15] If, instead of making the credit available by the seller's draft on the bank, the letter of credit provided merely for *payment*, as is occasionally done, on presentation of documents, the similarity would be much more apparent. The provision that the seller should draw under the credit serves several purposes. It is a convenient means by which the seller in a distant place may avail himself of the credit. Upon payment by the bank opening the credit, these drafts serve as vouchers to be used to reconcile accounts with the buyer. But most important, it contemplates the issue of an instrument negotiable in form of which the bank is a conditional acceptor, or at least which the bank is obligated to accept or pay.[16] It would seem to be clear from this that the parties intend the payment feature of a credit to be transferable, that is, the provision that the credit is to be availed of by seller's drafts indicates the intention that payment be made to *seller or order*—precisely as would be the case if the buyer's draft in negotiable form were to be issued.

It is an entirely different matter to consider whether the seller can by assignment or otherwise designate anyone else to fulfill the conditions of the credit, as by shipping the goods called for. The seller on principles of ordinary contract law might assign his rights under the seller-buyer contract.[17] But, as noted above, a letter of credit contemplates payment against documents only, and this ordinarily before any goods have arrived. In fact the bank may be entitled to indemnity although no shipment is ever made. The buyer then relies largely on the character and standing of the seller. It is this narrow margin of security which is afforded the buyer by having the seller himself procure the specified documents, that justifies the buyer in arranging such a credit at all. If the bank's contract with the seller is read in the terms it is written, that is, that the bank will *pay* the seller or to his order *only* on condition that drafts are drawn by the seller and that the specified documents are provided by the seller, it would seem impossible to hold that an assignee of the seller's

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[15] The discussion here relates to the ordinary irrevocable commercial import credit, but it may with some modifications apply equally to other forms, as for example, the confirmed credit. There is little distinction in legal theory between an import and an export credit.

[16] The promise to accept, being conditional, would probably not come within section 135 of the N. I. L., so as to constitute an acceptance. Muller v. Kling, 209 N. Y. 239, 103 N. E. 138 (1912). It is well established, however, that the issuing bank is under a duty to the holder of the draft to accept or pay. Russell v. Wiggin, *supra* note 1.

[17] As a matter of practice banks provide in the buyer's application agreement that the bank may at its option pay against drafts submitted by receivers, trustees in bankruptcy, and others, in some degree representing the beneficiary.

rights on the sales contract might recover of the bank.[18] To revert to the illustration of the buyer's draft on the bank accepted conditionally—the analogy is good—the draft would be transferable, but it would seem evident that no power would be given to any transferee himself to fulfill conditions expressly limited to the seller.

Following this line of thought, it will readily be seen that the question of what constitutes consideration for the bank's obligation takes its proper place. It is elementary in the law of bills of exchange that the payee (seller) may recover of the acceptor (bank) provided only that he took in good faith, before maturity and for value. The acceptance once given is irrevocable. The drawer has no power to stop payment. The acceptor is bound although the acceptance was subsequent to the giving of value by the payee,[19] and, for that matter, even although no consideration was given to the acceptor and the drawer's name was forged.[20] None of the letter of credit cases appears to conflict with any of these principles, viewing the credit as an accepted bill as above suggested. Still there have been no situations presented to the courts raising these questions as sharply as they have arisen in the cases relating to bills of exchange. But if the analogy here suggested were to be applied, credits once issued in irrevocable form to a bona fide seller would be irrevocable in the fullest sense, a result just as desirable as to credits today as it was as to accepted bills of exchange in the days of Lord Mansfield. A seller, who has been provided with a credit, wants assurance that it is as good as the bank writing the letter. He does not want to feel that he must hurry to change his position so as to work an estoppel. To make the credit subject to revocation for reasons of which he knows nothing and which ordinarily he would have no way of disputing, would be unfortunate, however well sustained by ordinary common law principles.[21]

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[18] Viewing the seller-buyer or seller-bank arrangements as non-personal contracts, they are of course assignable. There are dicta to the effect that an assignee might recover from the bank, but it does not appear ever to have been squarely held that he might perform conditions limited to the seller and recover on the bank-seller contract. *Cf.* Old Colony Trust Co. v. Continental Bank of New York, 288 Fed. 979 (S. D. N. Y. 1921).

[19] Commercial Bank of Lake Erie v. Norton & Fox, 1 Hill, 501 (N. Y. 1841).

[20] N. I. L. §§ 52, 57 and 62. *Cf.* Price v. Neal, 3 Burr. 1354 (K. B. 1762).

[21] It is assumed that although the seller would be in the position of payee on the credit, he might in accordance with the better view as to bills and notes be treated as a holder in due course. It would also seem fairly clear that the seller's obligation to the buyer on the seller-buyer contract would constitute "value." N. I. L. § 25. A more difficult question, however, may be raised by the provision that when notice of an "infirmity" is given to

It will be noted that nothing here suggested conflicts with the idea that the seller-buyer, bank-seller and bank-buyer contracts are distinct. They should be so regarded, just as are the contracts of drawer, payee and drawee on a bill of exchange. In at least one particular, however, courts appear to have gone farther in recognizing this distinctness than they might have, had the credit been regarded as a bill of exchange. In the *O'Meara* case,[22] the seller himself presented documents under a letter of credit to the bank which had opened the credit, and payment was refused because the bank had been advised that the seller had not shipped goods of the required quality, although the documents in form complied with the stipulations of the credit. The court was impressed with the argument that a bank could not be expected to determine whether the merchandise shipped conformed to the seller-buyer's contract or not, and gave judgment for the seller. But had the buyer given the seller a draft accepted by the same bank, to use the analogy here suggested, and had the buyer notified the bank not to pay for the same reason, the bank would have been in just the situation the court thought impossible.[23] It seems possible that, in the few cases where presentment is made by the seller himself under a credit, the inquiry might well be whether the seller has acted in good faith and given value, just as would be required in the case of an accepted draft. Ordinarily the seller's drafts will be presented by a holder in due course, so that the bank would be under a duty to pay,

a holder before he has paid all the agreed consideration, he may be a holder in due course only to the extent of the amount actually paid before notice. N. I. L. § 54. This section appears to have been applied only in cases of partial *payments* as distinguished from partial *shipments*. See BRANNAN, NEGOTIABLE INSTRUMENTS LAW (4th ed. 1926) 410–416. It codifies the case of Dresser v. Missouri Construction Co., 93 U. S. 92 (1876) relating to payments. It should be limited to such transactions. It is much more important to a seller that his rights be determined at an early date than it is to one who has merely undertaken to pay money. For instance, if sugar is contracted to be sold at 28 cents and drops to 6 cents before the seller has made actual shipment, it would, practically speaking, entirely deprive the seller of his bargain to allow the issuing bank (acceptor) to revoke (say for example in case of the buyer's insolvency) on the ground that the seller had not performed his obligations to the buyer before notice given. In support of this there is authority indicating that, in case the seller's obligation to the buyer would not be affected, section 54 would not apply. Griswold v. Morrison, 53 Calif. App. 93, 200 Pac. 62 (1921). Of course the right of anyone discounting the seller's drafts under the credit without notice and for value would be protected, on the theory here suggested, notwithstanding the bank's attempted revocation.

[22] *Supra* note 2.

[23] The decisions as to certified checks may throw some light on the problem although perhaps accepted drafts and certified checks are not treated as being on the same footing. It is clear that a holder in due course may require the certifying bank to pay although the drawer may attempt to stop payment. N. I. L. § 57; Central Guarantee Trust Co. v. White, 206

provided only the documents stipulated for were in proper order and duly presented.

Applying the analogy above suggested to the facts of the instant case, it may be said that the seller should be under a disability to collect from the buyer so long as the credit is outstanding. This would be comparable to the case where the seller has received the buyer's draft.[24] But the analogy to a bill of exchange should not be pushed to the extent of allowing recovery against the buyer (drawer) on the credit as if it were a bill of exchange. Obviously the discounting bank holds nothing evidencing any contractual obligation of the buyer to it. To give a recovery, depriving the buyer of counter-claims good as against the seller, would be contrary to the understanding of all parties to the transaction. On the other hand, the discounting bank would seem to be equitably entitled to the security to be found in whatever rights the seller might have on the sales contract. The purchase of the seller's draft under the credit accompanied by the invoice of sale would evidence the intention of both parties to transfer the seller's right against the buyer.[25]

Thus the analogy of letters of credit to bills of exchange, while of value in many ways, has its limitations. This might be ex-

Pa. St. 611, 56 Atl. 76 (1903). But although the holder is not a holder in due course, there appear to be some situations in which the drawer may yet not be able to stop payment. Sutter v. Security Trust Co., 96 N. J. Eq. 644, 126 Atl. 435 (1924); (1925) 23 MICH. L. REV. 531; Blake v. Hamilton Bank, 79 Ohio, 189, 87 N. E. 73 (1908). When the holder is acting fraudulently, there is apparently no justification for allowing him to recover. It is possible that the O'Meara case may be in accord on its facts with these rules as to certified checks. But the language of the decision, in saying that the bank need only regard the documents presented, would appear to go much further.

[24] In such a case it is clear that the drawer is under an immunity from collection of the debt (buyer-seller contract) until the draft has been dishonored and due notice given. Whether a letter of credit is to be deemed to be given in absolute or conditional payment remains to be decided. But as the majority view as to bills of exchange is that they are given only as conditional payment, it may be reasoned that the seller's rights against the buyer on the sales contract would revive in case the bank issuing the credit were to fail and reasonable notice were given the buyer. This would meet the argument of counsel for the buyer in the present case to the effect that merely providing the credit as agreed was a full performance on the buyer's part. Whether notice must be given as promptly as if the credit were a bill may well be doubted.

[25] Substantially this situation has been passed upon in a case where the only document required in addition to the principal draft was the drawer's draft on a third party. Although this second draft was never presented, it was held that a bank which had discounted the first draft was entitled to the proceeds of the debt for which the second draft was drawn. Muller v. Kling, *supra* note 16. Transfer of an invoice without bills of lading would, however, probably not transfer property in the goods to the discounting party, although it might transfer the debt. Cox v. Griel Bros. Co., 208 Ala. 250, 94 So. 292 (1922).

pected in view of the rather specialized function which the modern documentary credit has come to perform. But in deciding new letter of credit cases there would appear to be every reason for looking to the law pertaining to bills of exchange for assistance. It would be preferable, and quite within the powers of the courts, to recognize the letter of credit as a specialty in many respects similar to bills of exchange.[26] Perhaps, however, all that may be expected will be an attempt to reach substantially the same end by making use of modified common law principles.

R. B. T.

"CORPORATE ENTITY"—ITS LIMITATIONS AS A USEFUL LEGAL CONCEPTION

The concept "corporate entity" has been so diversely explained and criticized[1] that it does not seem amiss to question its present-day usefulness—to query whether the harm which may result from regarding a corporation as an "entity" is or is not greater than the benefit which may accrue from using the term as a shorthand device to express the result attained in a given situation. Two recent cases disregard the entity in order to reach an equitable result. In *Bressman, Inc. v. Mosson,* 127 Misc. 282 (N. Y. Sup. Ct. App. T. 1926), the plaintiff corporation conducted its business through A, its president. No shares had been issued to B and C, each of whom had contributed one-half the capital. A contracted, in his individual capacity, to buy certain land of the defendant, paying the latter by checks which he signed as president of the corporation. The corporation then sued to recover the amount of the checks on the theory that the defendant had notice that A was misusing corporate funds. The lower court directed a verdict for the plaintiff. *Held,* that the judgment be reversed on the ground that "the court will not permit the fiction of the corporate entity to be used to perpetrate a fraud." Inasmuch as there had never been a directors' meeting, nor a payment of dividends, nor had any financial statements been made to the shareholders, the court felt justified in announcing that the corporation was A's *alter ego.*[2]

[26] For an interesting discussion of the Continental view of the letter of credit, and a plea that, where possible, American law should be kept in accord with it as an aid to international trade, see Hershey, *Letters of Credit* (1918) 32 HARV. L. REV. 1.

[1] See Wormser, *Piercing the Veil of Corporate Entity* (1912) 12 COL. L. REV. 496; Hogg, *The Personal Character of a Corporation* (1917) 33 L. Q. REV. 76; *cf.* Canfield, *The Scope and Limits of the Corporate Entity Theory* (1917) 17 COL. L. REV. 128; Ballantine, *Separate Entity of Parent and Subsidiary Corporations* (1925) 14 CALIF. L. REV. 12; see also (1925) 13 CALIF. L. REV. 235; (1920) 4 MINN. L. REV. 219; (1926) 10 *ibid.* 598; (1923) 36 HARV. L. REV. 737.

[2] The term *alter ego* as applied to a corporation is merely a statement of the result reached in a given case—that on its facts the corporate entity

In *State Trust & Savings Bank v. Hermosa Land & Cattle Co.*, 240 Pac. 469 (N. M. 1925) H, the president of a corporation, contracted to sell its entire assets to W who paid part of the purchase price in cash. In order to limit his responsibility, W accepted all the shares of the corporation in lieu of a transfer of the property, and executed notes of the corporation for the balance of the purchase price to H as trustee for the old shareholders. Subsequently, W discovered that H had made fraudulent misrepresentations to induce the sale and refused payment of the notes on this ground. In an action against the corporation on these notes, W was allowed recoupment for the fraud in spite of the plaintiff's objection that the cause of action for fraudulent misrepresentations belonged to W in his personal capacity whereas this was an action against the corporation. The court cited a number of recent cases to show that "courts have looked beyond the corporate entity, not because it was fraudulent in itself, but merely because to recognize it in the particular case would result inequitably." [3]

In order to discuss the soundness of such decisions it is necessary to define—as far as definition is possible—the terms "corporation" and "entity." The late Professor Hohfeld treated a corporation as "just an association of natural persons conducting business under legal forms, methods, and procedure that are *sui generis*. The only conduct of which the state can take notice by its laws must spring from natural persons—it cannot be derived from any abstraction called the 'corporate entity.' . . . When, . . . in accordance with the customary terminology, we speak of the corporation, as such, as contracting in the corporate name, as acquiring, holding, and transferring property, and as suing and being sued, and when we speak of stockholders as mere claimants against the corporation, holding stock, which is a species of personal property,—and so on indefinitely—we are merely employing a short and convenient mode of describing the complex and peculiar process by which the benefits and burdens of the corporate members are worked out." [4]

Adopting this concept of a corporation it appears that little remains to which we can attach the name "entity." The term, as applied in law, merely denotes that in a given situation the legal relations of the several associates in an enterprise will be determined as if the associates were one, this being the simplest

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will be disregarded. It is synonymous with the term "dummy" or "mere instrumentality."

[3] At 473, 474, citing Minifie v. Rowley, 187 Calif. 481, 202 Pac. 673 (1921); Pott v. Schmucker, 84 Md. 535, 36 Atl. 592 (1897); Home Fire Ins. Co. v. Barber, 67 Neb. 644, 93 N. W. 1024 (1903).

[4] HOHFELD, FUNDAMENTAL LEGAL CONCEPTIONS (1923) 198, 200.

procedure where it works no injustice.[5] The mere fact of incorporation, *i. e.*, the doing of the acts which by statute are made conditions precedent to recognition as a corporation is not solely operative to effect this result. If that were so the law of corporations would, indeed, be simple. Corporations, however, are not the only type of organization that has been treated as an entity; nor is a corporation to be treated as an entity at all times or for all purposes. A group of unincorporated associates has been recognized as an entity for the purpose of being indicted for violation of the criminal law,[6] of suing or being sued,[7] of levying upon the share certificates of its members,[8] of taxation,[9] and for the purpose of serving process.[10] Yet judging from the reluctance of many courts and writers to disregard the separate entity as applied to corporations, one would be led to believe that the "entity" was the unique and distinctive quality of an incorporated group.

[5] Sturges, *Unincorporated Associations as Parties to Actions* (1924) 33 YALE LAW JOURNAL, 383. Professor Dewey has recently criticized the reification of the term "person" as applied to corporations—the "entity" concept under a different name. "What 'person' signifies in popular speech, or in psychology, or in philosophy or morals, would be as irrelevant, to employ an exaggerated simile, as it would be to argue that because a wine is called 'dry,' it has the properties of dry solids; or that, because it does not have those properties, wine cannot possibly be 'dry.' Obviously, 'dry' as applied to a particular wine has the kind of meaning, and only the kind of meaning, which it has when applied to the class of beverages in general. Why should not the same sort of thing hold of the use of 'person' in law?" He suggests "eliminating the *idea* of personality until the concrete facts and relations involved have been faced and stated on their own account: retaining the *word* will then do no great harm." Dewey, *The Historic Background of Corporate Legal Personality* (1926) 35 YALE LAW JOURNAL, 655, 656, 673.

[6] United States v. Adams Express Co., 199 Fed. 321 (W. D. N. Y. 1912). The same joint stock company was, however, held not to be an entity in Rountree v. Adams Express Co., 165 Fed. 152 (C. C. A. 8th, 1908) where the court refused to permit it to sue in the federal courts on the basis of diversity of citizenship. *Acc:* Great So. Fire Proof Hotel Co. v. Jones, 177 U. S. 449, 20 Sup. Ct. 690 (1899).

[7] United Mine Workers v. Coronado Coal Co., 259 U. S. 344, 42 Sup. Ct. 570 (1922) (trade union). *Contra:* White v. Shipley, 48 Utah, 496, 160 Pac. 441 (1916) where plaintiff sued defendant, a joint stock company, as a corporation, and the court denied relief because of failure to prove that defendant was a corporation. A statute permitting actions against joint stock companies in their common name was held inapplicable. *Cf.* Hanley v. American Ry. Express Co., 244 Mass. 248, 138 N. E. 323 (1923) where an automobile registered in the name of a trade union was held improperly registered and relief denied for injuries inflicted.

[8] Beal v. Carpenter, 235 Fed. 273 (C. C. A. 8th, 1916) (substituted service at place where certificates were located, *held* to confer jurisdiction *in rem*, the owner and physical property being in another state).

[9] Liverpool Ins. Co. v. Massachusetts, 10 Wall. 566 (U. S. 1870); People v. Coleman, 133 N. Y. 279, 31 N. E. 96 (1892).

[10] Adams Express Co. v. State, 55 Ohio, 69, 44 N. E. 506 (1896).

The fact that, for many purposes, corporations are denied the entity attribute, while on the other hand many unincorporated associations are often treated as entities for a particular purpose, reveals the non-sanctity of the entity notion in any particular instance. The most frequent case of "piercing the corporate veil" is one where a third party seeks to impose individual unlimited responsibility on the associates who endeavor to perpetrate a fraud by treating themselves as distinct from the corporate entity, and in nowise responsible for its acts. It is obvious here that a strict adherence to the entity theory would place the courts in the anomalous position of aiding the defrauders while injuring the party defrauded. *Bressman, Inc. v. Mosson* is just such a case. Yet even there the lower court refused to recognize that the corporation was merely the sole shareholder under another name.

When, in the development of the law of corporations, the entity theory had been brushed aside to permit an action in the federal courts on diversity of citizenship[11] it became apparent that the fact of incorporation did not create a separate entity for all purposes. The entity was soon disregarded to prevent fraud.[12] Courts of equity then made further inroads by rejecting the theory in any case where, although no fraud existed, a rigid adherence to the entity view would result inequitably.[13] Courts of law, especially under modern codes, soon followed.[14] At present, there is a tendency to disregard the entity in cases not involving fraud on the part of the associates, or equities of third parties, if such procedure will facilitate the settlement of all disputes between the litigants under the particular circumstances presented to the court. The soundness of this liberalizing tendency is clearly illustrated in *State Trust & Savings Bank v. Hermosa Land & Cattle Co.* Had the court adopted the theory of its critics[15] it could not have found any consideration for the

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[11] Bank of United States v. Deveaux, 5 Cranch, 61 (U. S. 1809). Marshall, C. J., is said to have regretted this decision. It was overruled in Louisville, C. & C. R. R. v. Letson, 2 How. 497 (U. S. 1844). See Wormser, *op. cit. supra* note 1.

[12] Booth v. Bunce, 33 N. Y. 139 (1865).

[13] Cases cited *supra* note 3; United States Gypsum Co. v. Mackey Wall Plaster Co., 60 Mont. 132, 199 Pac. 249 (1921).

[14] Wenban Estate v. Hewlett, 193 Calif. 675, 227 Pac. 723 (1924); Dillard & Coffin Co. v. Richmond Cotton Oil Co., 140 Tenn. 290, 204 S. W. 753 (1918).

[15] It is suggested, in (1926) 39 HARV. L. REV. 652, that the sole stockholder who had been defrauded "should be remitted to a separate action against the persons who are responsible for his injury." It is submitted that such procedure would be a triumph of form over convenience, especially in view of the present crowded court dockets and the saving of time and expense in settling as many disputes as possible in one action. In (1926) 10 MINN. L. REV. 598, 608, the conclusion is reached "that except in those

notes "since the corporation received nothing which it did not already possess"; it would be "ultra vires the corporation" to agree to pay the individual debt of a shareholder. Such were the contentions of the defendant. On the other hand, it would have found, as the plaintiff contended, that "any false representations concerning those assets worked no damage to the corporation, but affected only the value of the stock, and damaged Wigmore only, and that his damage is not to be considered in a suit solely against the corporation"; that the defrauder was the corporation, acting through its president, and not the shareholders (present plaintiffs); and that if W "suffered damage through their falsity, his cause of action is against the corporation." In refusing to be trammeled by outworn theories of a separate entity the court was able to look to the real nature of this complicated transaction, to find consideration and to adjust all the rights of the parties in one action.

In a recent Supreme Court case[16] a similar result was reached at the behest of the sole shareholder. The defendant presented a fraudulent claim against the Emergency Fleet Corporation of which the United States was sole shareholder. *Held,* that this constituted a conspiracy to defraud the United States.[17] A contrary result was reached by a recent state court decision.[18] A statute authorized a city to levy an assessment on landowners for part of the purchase price of a street railway, should it purchase the same. The city bought all of the shares therein (rather than the property as such) and continued to operate the railway as a corporation. The court invalidated an assessment made within the purported terms of the statute on the ground that the city had bought not the railway, but merely its shares —that the corporation remained the real owner. It is submitted

cases where fraud or evasion of statute are present and no other means of preventing it is available, the concept of a corporate entity separate and distinct from its stockholders should not be lightly disregarded," and that such cases as the instant one "are unnecessary triflings with an important, essential and convenient principle of corporation law." It would appear that a mere statement of the complicated facts in this case should be sufficient to show the necessity of disregarding the "entity" here.

[16] United States v. Walter, 263 U. S. 15, 44 Sup. Ct. 10 (1923).

[17] Holmes, J., squarely placed the decision on grounds of public policy ". . . while it is true that the corporation is not the United States . . . the contemplated fraud upon the corporation if successful would have resulted directly in a pecuniary loss to the United States, and even more immediately would have impaired the efficiency of its very important instrument." At 18, 44 Sup. Ct. at 11. Compare this with situations where the same corporation was treated by the same court as a separate entity, policy not dictating a contrary holding. Sloan Shipyards Corp. v. Emergency Fleet Corp., 258 U. S. 549, 42 Sup. Ct. 386 (1921); Emergency Fleet Corp. v. Wood, 258 U. S. 549, 42 Sup. Ct. 386 (1921); and see (1922) 36 HARV. L. REV. 218.

[18] Chilson v. Sweeney, 247 Mass. 191, 141 N. E. 872 (1924).

that these cases can be reconciled only as representative of diverse views as to the policy behind a particular statute. If the court favors a broad construction of the statute the entity will be ignored; if a narrower view is taken it is sustained by insisting upon the separation of stockholders as such from the same individual as a corporation. In a recent case[19] a statutory landlord's lien was given for any supplies furnished by a landlord to his tenant. F was the sole shareholder of the defendant corporation which owned premises leased to L. F individually owned a store, but pooled both corporate and personal assets. Goods were supplied to L from the store, for which a landlord's lien was claimed by the corporation on the theory that F and the corporation were one. *Held*, that the two were separate entities, and that therefore no lien would be given for the goods. It is not unreasonable to believe that a contrary result might have been reached had there been any compelling social policy to sustain a lien in such a case.[20]

The conclusion to be drawn from these cases is that the term "entity" merely signifies the result reached by a court in a given case. Reasons for the decision should always exist independently.[21] When so considered the term "entity" is useful only because it is convenient. Where the same group of associates is indicated as a unit in one case, and in another denied the power to sue as a unit in the federal courts,[22] it is obvious that the individuals cannot be said to constitute "an entity." The result reached in the first case is conveniently stated by an assertion that they are an entity; and in the second case that they are not. The term "entity," therefore, cannot be usefully employed apart from the particular issue—and then only to state the result reached. No hard and fast rule of what is "convenient" or "equitable" or "just" can be laid down. Much depends on the particular facts in a given case and the policy to be sponsored by the court. The "courts will draw aside the web of entity, will regard the corporation as an association of live, up-and-doing men and women shareholders, and will do justice between real persons . . . where used as a cloak for wrongdoing . . . . There could be no better refutation of the charge so frequently made *horis novissimis* that courts are inelastic, unyielding and unwilling to respond to social and economic facts than the adjustment—still in process—of corporate concepts to

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[19] Houston Nat'l Exch. Bk. v. Osceola Irrigation Co., 261 S. W. 56 (Tex. Civ. App. 1924).

[20] A similar result was reached in Ayer & Lord Tie Co. v. Commonwealth, 208 Ky. 606, 271 S. W. 693 (1925) where a disregard of the entity would have exempted the petitioner from a tax assessment.

[21] Sturges, *op. cit. supra* note 5.

[22] *Supra* note 6.

modern business facts."[23] That the adjustment has been and still is in process is well illustrated by the recent cases which allow the incorporators themselves to pierce the corporate veil where no allegation could possibly be made that the associates were using the entity as a "cloak for wrongdoing." Such progress is welcome and should not be hampered by a hypostatization of the "entity" concept.

ENFORCEMENT OF THE 18TH AMENDMENT IN THE ABSENCE OF STATE LEGISLATION

Since the repeal of the Mullen-Gage Law in 1923, New York has had no statute to enforce the Eighteenth Amendment.[1] The inadequacy of the present federal judicial machinery to cope with the enforcement problem by itself is clearly evidenced by the congestion of the federal courts in New York. This situation has raised the question as to whether state courts can prosecute liquor cases in the absence of state enforcement legislation. In the recent case of *People v. Conti,* 127 Misc. 244 (N. Y. Sup. Ct. 1926) the defendant, who had maintained premises for the sale of intoxicating liquors (such maintenance being specifically made a nuisance under the National Prohibition Act)[2] was indicted for conducting a public nuisance in violation of section 1530 of the New York Penal Law.[3] The indictment was dismissed on the ground that a violation of the National Prohibition Act is not an offense against the state of New York, and also that no act was alleged that is a public nuisance under the New York statute.

The sources of state and federal powers in the matter of prohibition enforcement are independent—that of the state arising from its general police power, and that of the federal government arising from the Eighteenth Amendment which also restricted and limited the pre-existing power of the several states so that no legislation enacted by them can give validity to acts prohibited by it.[4] Each government may, however, enact laws to enforce prohibition without interfering with the other. A violation of a state enforcing act would be an offense against that state only; and a violation of a federal enforcing act would be an offense against the federal government only . A single act, therefore, may violate both state and federal enforce-

[23] Wormser, *op. cit. supra* note 1, at 517, 518.

[1] As a result of a recent referendum, Montana is also without a state enforcement act. N. Y. Times, Nov. 4, 1926, p. 1, *ibid.* Nov. 5, 1926, p. 4.

[2] 41 Stat. 305, (1919) U. S. Comp. Stat. (Supp. 1923) Title LXVIII A, § 10138.

[3] N. Y. Ann. Cons. Laws (2d ed. 1917) 5940.

[4] Commonwealth v. Nickerson, 236 Mass. 281, 128 N. E. 273 (1920); Ex parte Gilmore, 88 Tex. Cr. App. 529, 228 S. W. 199 (1920); Dowling, *Concurrent Power Under the Eighteenth Amendment* (1922) 6 MINN. L. REV. 447; (1921) 10 CALIF. L. REV. 70.

ment statutes. Such an act is a separate offense against each, and prosecution by the former one is no bar to prosecution by the latter.[5] Under such circumstances, is it possible for a state which has no enforcement statute, to prosecute a violation of the federal enforcing statute?

In civil cases arising under federal statutes, state and federal courts have concurrent jurisdiction[6] unless the matter is expressly reserved to the federal courts, for the state courts had jurisdiction prior to the formation of the Federal Constitution.[7] While some state courts have considered the exercise of concurrent jurisdiction optional,[8] the Supreme Court in the *Second Employers' Liability Cases*[9] held that where a federal law replaces state civil laws, under which state courts have been giving remedies, it is incumbent on the state courts to take jurisdiction, and apply the federal law. State courts, however, have no jurisdiction over acts which are crimes exclusively against the United States, even when it is apparently granted by federal statute, because no such power existed before the Federal Constitution, and the Constitution does not sanction any such grant.[10] Hence it would seem that state courts could not properly take jurisdiction over a violation of any national enforcement legislation, even if section 256 of the Judicial Code,[11] which gives exclusive jurisdiction over criminal offenses against the United States to the federal courts, were repealed.

The policy of permitting a state, by repeal of its enforcement legislation, to shift the burden of enforcement to the federal courts, and thereby lessen the effectiveness of prohibition, may be questioned.[12] The doctrine of the *Second Employers' Liability*

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[5] United States v. Lanza, 260 U. S. 377, 43 Sup. Ct. 141 (1922); Herbert v. Louisiana, N. Y. Times, Nov. 2, 1926, p. 1, which confirms the Lanza case.

[6] Claflin v. Houseman, 93 U. S. 130 (1876); Stearns v. United States, Fed. Cas. No. 13, 341 (C. C. A. 2d, 1835).

[7] Hamilton, *The Federalist*, No. 82.

[8] Rushworth v. Judges, 58 N. J. L. 97, 32 Atl. 743 (1895); see Prigg v. Pennsylvania, 16 Pet. 539, 622 (U. S. 1842); Warren, *New Light on the History of the Federal Judiciary Act of 1789* (1923) 37 HARV. L. REV. 49, 70.

[9] 223 U. S. 1, 32 Sup. Ct. 169 (1911).

[10] State v. McBride, 1 Rice, 400 (S. C. 1839) overruling State v. Wells, 2 Hill L. 687 (S. C. 1835); see Martin v. Hunter, 1 Wheat. 304, 337 (U. S. 1816); Stearns v. United States, *supra* note 6, at 311. *Contra:* Hartley v. United States, 3 Hayw. 45 (Tenn. 1816).

[11] 1 Stat. 76, (1789) U. S. Comp. Stat. (1916) § 1233.

[12] "The eighteenth amendment has indeed opened an interesting field in the operation of our dual scheme of government. It has brought into strong relief the inadequacy of the organization of the federal government, especially its judicial branch, to deal with so widespread a question as prohibition; it has shown that state and national government machines must operate harmoniously to put into effect a police policy declared to be

Cases[13] might be applied in criminal cases if the view were taken that state legislation is merely ancillary to federal legislation, and that a violation of either is an offense against both governments. But this would be in conflict with the recent holdings as to the relation of federal and state sovereignties in this situation and as to former jeopardy.[14] Such a result would seem to be more in keeping with Article VI, clause 2 of the Constitution[15] which, apparently, has received little consideration in this connection.

Apart from the problem as to the jurisdiction of state courts over federal offenses, the question arises as to whether the facts in the *Conti* case might not have been considered as the maintenance of a public nuisance in violation of the New York penal statute. This statute has been construed by the New York courts as being merely a formulation of the common law definitions of public nuisance.[16] Hence it does not necessarily prevent any given act from being a public nuisance because it is not specifically defined as such in the statute. In fact a place where intoxicating liquors are sold has been held in some jurisdictions to be a public nuisance, even in the absence of a statute specifically defining it as such, if the sale was illegal under a state statute.[17] A reason for this is the likelihood of public disorder resulting from the enforcement of the state statute. The 18th Amendment

national, but affecting individuals so widely, and it has brought into the open the inconvenience of a double system of police regulations of the same article in the same country. The attempts made by the states and the nation to meet the situation constitutes a chapter in our constitutional development well worth watching. It also makes evident the wisdom of the division of powers in the Constitution between state and nation and the importance as a general rule of reserving the police powers to the state. Only where the need is national, where it must be met by national action should the nation seek to extend its scope of action at the expense of local responsibility to local opinion, which is one of the cornerstones of the constitutional system set up by the Philadelphia Convention in 1784." Chamberlain, *Enforcement of the Volstead Act Through State Agencies* (1924) 10 AM. B. A. J. 391, 394.

[13] *Supra* note 9.

[14] *Cf.* United States v. Lanza, *supra* note 5; Herbert v. Louisiana, *supra* note 5; Lanier, *Prohibition and Double Jeopardy* (1923) 8 VA. L. REG. (N. S.) 740.

[15] "This Constitution, and the Laws of the United States which shall be made in pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the Supreme Law of the Land and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." But see Dowling, *op. cit. supra* note 4, at 478.

[16] People v. Borden's Condensed Milk Co., 165 App. Div. 711, 151 N. Y. Supp. 547 (2d Dept. 1915), *aff'd* 216 N. Y. 658, 110 N. E. 1046 (1915).

[17] Walt v. People, 46 Colo. 136, 104 Pac. 89 (1909); Lofton v. Collins, 117 Ga. 434, 43 S. E. 708 (1903); Parker v. State, 61 N. J. L. 308, 39 Atl. 651 (1898), *aff'd* 62 N. J. L. 801, 45 Atl. 1092 (1899); Smith v .Commonwealth, 6 B. Mon. 21 (Ky. 1845).

makes *sales* of intoxicating liquors illegal, and no legislation or absence of legislation on the part of a state can make any such sale lawful. A violation of the Amendment should be as great a public nuisance as a violation of a state statute. A place where a federal law is violated is just as likely to be the center of public disturbances as premises where a state law is violated. The term "public nuisance" is, at its best, a broad ambiguous term. Whether or not a given group of facts will constitute a public nuisance often depends largely on the emotional reaction of the court. It is submitted that the facts of the *Conti* case might well have been held to have been such a nuisance. Further support for this view may be gained from the fact that New York courts have enjoined the maintenance of a place for the sale of liquor as being a public nuisance.[18]

ANTICIPATORY BREACH OF UNILATERAL CONTRACTS

When there is an anticipatory repudiation by one party to a bilateral contract, the other has an immediate right to damages for the "breach." [1] But this rule was limited by Chief Justice Fuller's statement[2] that it applied only to mutually executory contracts and would not allow an action upon contracts to pay money, executory on one part only, before the time specified for payment.[3]

[18] United States v. Sumner, 125 Misc. 658, 211 N. Y. Supp. 705 (Sup. Ct. 1925), *aff'd* 216 App. Div. 782, 214 N. Y. Supp. 930 (4th Dept. 1926).

[1] This is the English rule. Hochster v. de la Tour, 2 El. & Bl. 678 (Q. B. 1853); Frost v. Knight, L. R. 7 Ex. 111 (1872); The Danube & Black Sea Co. v. Xenos, 13 C. B. (N. S.) 825 (1863). See also discussion in note to Cutter v. Powell, 2 SMITH'S LEADING CASES (12th ed. 1915) 48-50. The same rule is followed in nearly every American jurisdiction. See cases collected in Roehm v. Horst, 178 U. S. 1, 20 Sup. Ct. 780 (1900); ANSON, CONTRACT (CORBIN'S ed. 1924) 463, n. 4; CORBIN, CASES ON CONTRACTS (1921) 749, n; (1906) 1 ANN. CAS. 427; (1909) 12 ANN. CAS. 1108; 3 WILLISTON, CONTRACTS (1920) 2363, notes 97, 98, 99; *ibid.* 2364, n. 1. *Contra:* Daniels v. Newton, 114 Mass. 530 (1874); King v. Waterman, 55 Neb. 324, 75 N. W. 830 (1898); Stanford v. McGill, 6 N. D. 536, 72 N. W. 938 (1897) [overruled by Hart-Parr Co. v. Finley, 31 N. D. 130, 153 N. W. 137 (1915)]; (1924) 33 YALE LAW JOURNAL, 659.

[2] "It has never been supposed that notice to the holder of a bond, or promissory note, or bill of exchange, that the other party would not (from any cause) comply with the contract, would give to the holder an immediate cause of action upon which he might sue before the time of payment arrived." Fuller, C. J., in Roehm v. Horst, *supra* note 1, at 17, 20 Sup. Ct. at 786, quoting from the opinion of Taney, C. J., in Greenway v. Gaither, Fed. Cas. No. 5788 (C. C. D. Md. 1853).

[3] Leon v. Barnsdall Zinc Co., 309 Mo. 276, 274 S. W. 699 (1925); Benecke v. Hoebler, 38 App. Div. 344, 58 N. Y. Supp. 16 (1st Dept. 1899), *aff'd* 166 N. Y. 631, 60 N. E. 1107 (1901); Moore v. Security Trust & L. Ins. Co., 168 Fed. 496 (C. C. A. 8th, 1909), certiorari denied, 219 U. S. 583, 31 Sup. Ct. 469 (1910); see Roehm v. Horst, *loc. cit. supra* note 2; Washington County v. Williams, 111 Fed. 801, 810 (C. C. A. 8th,

The decision in the recent case of *Federal Life Ins. Co. v. Rascoe,* 12 Fed. (2d) 693 (C. C. A. 6th, 1926) would seem to be a step toward breaking away from this distinction drawn between anticipatory breaches of bilateral and unilateral contracts. In this case, the plaintiff held an insurance policy under which she was entitled to receive from the defendant a certain sum each week so long as she was totally disabled. The payments were made conditional upon her furnishing a report each month from her attending physician. Although the plaintiff was disabled for life the defendant ceased making payments after eight months and denied any further obligation under the contract. From a lump sum judgment for the plaintiff, the defendant appealed on the ground that there can be no anticipatory breach of a unilateral contract for the future payment of money. The court, however, one judge dissenting, affirmed the decision of the trial court.[4]

The doctrine of anticipatory breach has been attacked because of the specious reasons often advanced by the courts in applying it.[5] The "reason" advanced by an early English case,[6] and re-

1901); Alger Fowler Co. v. Tracy, 98 Minn. 432, 437, 107 N. W. 1124, 1126 (1906); Nicholas v. Scranton Steel Co., 137 N. Y. 471, 487, 33 N. E. 561, 566 (1893); Ballantine, *Anticipatory Breach and the Enforcement of Contractual Duties* (1924) 22 MICH. L. REV. 329, 350. "Indeed the right to the unimpeached efficacy of the obligation before its maturity, is perhaps as desirable in the case of a promissory note as in any other case which can be put; yet it is probable that no court would enforce a promissory note prior to the date of its maturity." 3 WILLISTON, *op. cit. supra* note 1, § 1328.

[4] The instant case is supported by the decisions holding that upon repudiation by the insurer of all obligation under a life insurance policy, a right of action to recover damages accrues at once. O'Neil v. Supreme Council, 70 N. J. L. 410, 57 Atl. 463 (1904); Merrick v. Northwestern Life Ins. Co., 124 Wis. 221, 102 N. W. 593 (1905). *Contra:* Kelley v. Security Mutual Life Ins. Co., 186 N. Y. 16, 78 N. E. 584 (1906); Porter v. American Legion, 183 Mass. 326, 67 N. E. 238 (1903); Langan v. Supreme Council, 174 N. Y. 266, 66 N. E. 932 (1903). "The contrary decisions of Porter v. American Legion and Langan v. Supreme Council must be deemed erroneous." 3 WILLISTON, *op. cit. supra* note 1, at 2369, n. 14. "That a contract of insurance includes by necessary implication a promise on the part of the insurer to accept premiums at the rate fixed by the original contract seems obvious; and this had indeed been so held by the New York Court of Appeals prior to its adoption of anticipatory breach." 3 *ibid.* § 1330.

[5] See Daniels v. Newton, *supra* note 1, at 532–541. Williston contends that a plaintiff in bringing an action for breach of contract must allege that the defendant broke the contract by not performing as promised—something that obviously has not occurred in the case of an anticipatory breach. Williston, *Repudiation of Contracts* (1901) 14 HARV. L. REV. 421, 428. See also 3 WILLISTON, *op. cit. supra* note 1, §§ 1296, 1306, 1311, 1313, 1316. "Suppose the defendant, after saying he will not perform, changes his mind and concludes to keep his promise. Unless the plaintiff relying on the repudiation, as he justly may, has so changed his position that he

peated again by a recent commentator,[7] was that a party "has a right to have the contract kept open as a subsisting and effective agreement. . . ." But to say that a man has a "right," and then contend that he should therefore have an action for an anticipatory breach is to argue in a circle. The "right," if present, is the conclusion, not a reason. In *Hochster v. de la Tour* the court said that if an instant right of action were not given, it would be necessary for the wronged party to remain ready and willing to perform his part of the contract without an opportunity of benefiting himself to the extent of working at something else or of benefiting the defendant by mitigating damages. Were this reason valid, the discrimination against actions for anticipatory repudiations of unilateral contracts would be justified. But there is no such necessity, for a repudiation could easily be held to give the injured party a privilege of not performing his part of the contract, and make his right to damages no longer conditional on his own readiness to perform, without at the same time creating an instant right to damages. Indeed, such was the holding in a leading Massachusetts case.[8]

This basis for the distinction between bilateral and unilateral contracts in regard to anticipatory breach is, therefore, unsound. "The best reasons for allowing an immediate action for an antici-

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can not go on with the contract without injury, the defendant ought to be allowed to do this. But if the plaintiff is allowed to bring an action at once this possibility is cut off. 'Why,' says Fuller, C. J., 'should a *locus poenitentiae* be awarded to the party whose wrongful action has placed the other at such disadvantage?' Because such is the contract the parties made. A promise to perform in June does not preclude changing position in May." 3 *ibid.* § 1321. But "it seems strange that the defendant, after renouncing the contract, and absolutely declaring he will never act under it, should be permitted to object that faith is given to his assertion, and an opportunity is not left to him of changing his mind." Lord Campbell, C. J., in Hochster v. de la Tour, *supra* note 1, at 690.

[6] "The promisee has an inchoate right to the performance of the bargain, which becomes complete when the time for performance has arrived. In the meantime he has a right to have the contract kept open as a subsisting and effective contract. . . . It is, therefore, quite right to hold that such an announcement [repudiation] amounts to a violation of the contract *in omnibus* and that upon it the promisee, if so minded, may at once treat it as a breach of the entire contract, and bring his action accordingly." See Frost v. Knight, *supra* note 1, at 114.

[7] Ballantine, *supra* note 3, at 351. Professor Ballantine, however, recognizes other and better reasons.

[8] "A renunciation of the agreement, by declarations or inconsistent conduct, before the time of the performance, may give cause for treating it as rescinded, and excuse the other party from making ready for performance on his part, or release him from the necessity of offering performance in order to enforce his rights. It may destroy all capacity of the party, so disavowing its obligations, to assert rights under it afterwards, if the other party had acted upon such disavowal." See Daniels v. Newton, *supra* note 1, at 533.

patory repudiation are that it frequently causes immediate loss in property values, it disturbs the mind and serenity of the promisee, an and immediate action makes for an early settlement of the dispute and a timely payment of damages." [9] These apply to unilateral as well as bilateral contracts. Repudiation reduces the sale value of the chose in action, for few people care to purchase a lawsuit. Also, the plaintiff should not be forced to bring a series of lawsuits for the regular installments, and in the meantime suffer discomfort and poverty.

But the court in the instant case purports not to depart from the limitation imposed by Chief Justice Fuller, explaining that there is no *unconditional* promise to pay a sum certain. The plaintiff is regarded as being under a "continuing burden" of submitting to physical examination and sending certificates to the defendant and hence the contract was not considered unilateral. The plaintiff has paid all the premiums due. But these "burdens" were merely conditions precedent to the plaintiff's right—conditions of a kind that are normally waived by anticipatory repudiation such that the plaintiff's secondary right to damages is unconditional.[10] The dissenting opinion rested solely upon the ground that the contract was unilateral and, therefore, in view of Chief Justice Fuller's limitation, no action could be maintained. The exact contract is not made clear in the statement of facts in the decision, but usually contracts of insurance are unilateral. A person is insured in consideration of a first payment. Payment of later premiums is a condition precedent to the right of the insured to collect on the policy. There may be other conditions, as there were here, precedent or subsequent to the right.

If the defendant's repudiation may be regarded as a present breach, there is no difficulty in granting full damages even though the contract is by its terms to continue into the future.[11] Such damages are often granted, without judicial discussion as

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[9] ANSON, *op. cit. supra* note 1, at 464.

[10] An anticipatory repudiation "causes the other party's secondary rights to damages or restitution to be no longer conditional on performance or tender thereof by himself." ANSON, *op. cit. supra* note 1, at 465. In Arkansas, the same result was reached under facts nearly identical with the instant case. The court denied, without discussion, the defendant's contention that the action was prematurely brought. Aetna Life Ins. Co. v. Phifer, 160 Ark. 98, 254 S. W. 335 (1923). Likewise in Missouri, where the plaintiff was the beneficiary of her husband's life insurance policy under which she was to receive a certain sum each week. The decision was partly based, however, on an insurance statute. Millburn v. Royal U. M. Life Ins. Co., 209 Mo. App. 228, 234 S. W. 378 (1921).

[11] This is analogous to granting a plaintiff present and future damages in one tort action. This practice is well recognized in Massachusetts, where Hochster v. de la Tour is not followed. Parker v. Russell, 133 Mass. 74 (1882).

to whether the contracts are unilateral or bilateral, in jurisdictions where *Hochster v. de la Tour* is followed with the limitations imposed by Chief Justice Fuller.[12]

A CONSIDERATION OF MECHANICS' BANK OF NEW HAVEN V. JOHNSON

It has been consistently held that a mortgage note containing an agreement to pay all taxes assessed on the note against the payee or holder does not meet the requirement of section 1 of the N.I.L.,[1] which provides that to be negotiable, an instrument "must contain an unconditional promise or order to pay a sum certain in money."[2] The first Connecticut decision on the point, *Mechanics' Bank of New Haven v. Johnson*, 104 Conn. 696, 134 Atl. 231 (1926) follows this view. As nearly all Connecticut second mortgage notes and many of the first mortgage notes contain such agreements, the holding is an important one in that jurisdiction.

A study of the Connecticut statutes on taxation of mortgage notes shows the reason for the almost universal use of this provision. For some time prior to 1851, money at interest secured by a mortgage on real estate was exempt from taxation.[3] Acts passed in 1851 and 1852 removed this exemption, and made it possible for the mortgagor, upon application, to have his tax list reduced by the amount of such indebtedness.[4] Theoretically this lightened the tax burden of the mortgagor at the expense of the mortgagee, but the actual result, in many cases at least, seems to have been the inclusion in mortgage notes of an agreement on the part of the mortgagor to pay the taxes assessed against the holder of the note. This practice was recognized by a statute passed in 1875, which provided that mortgage notes containing such agreements should be exempt from taxation "to an amount equal to the assessed value" of the property mortgaged.[5] As a result this agreement became practically universal in Connecticut, and was incorporated in the printed note forms.

[12] Pierce v. Tennessee Coal Co., 173 U. S. 1, 19 Sup. Ct. 335 (1899); East Tennessee Va. & Ga. R. R. v. Staub, 75 Tenn. 397 (1881); Aetna Life Ins. Co. v. Phifer, *supra* note 10; Packas v. Hollingshead, 184 N. Y. 211, 77 N. E. 40 (1906); Millburn v. Royal U. M. Life Ins. Co., *supra* note 10.

[1] Adopted by Connecticut, Conn. Gen. Stat. (1918) § 4359.

[2] Coolidge v. Saltmarsh, 96 Wash. 541, 165 Pac. 508 (1917); Bright v. Offield, 81 Wash. 442, 143 Pac. 159 (1914); Smith v. Myers, 207 Ill. 126, 69 N. E. 858 (1904); Carmody v. Crane, 110 Mich. 508, 68 N. W. 268 (1896); Farquhar v. Fidelity Ins. Co., Fed. Cas. No. 4676 (C. C. E. D. Pa. 1878).

[3] Conn. Gen. Stat. (1838) 604, § 2.

[4] Conn. Gen. Stat. (1854) 839, § 8; 849, § 41; 852, §§ 1, 2.

[5] Conn. Pub. Acts 1875, c. 27; Conn. Gen. Stat. (1888) § 3824; Conn. Gen. Stat. (1902) § 2319.

Its universality is attested by the fact that the provision, which enabled a mortgagor to reduce his tax list to the extent of his mortgage indebtedness for which another was liable to be taxed, was omitted in the Revision of 1902.[6] The statute of 1875 remained effective forty years; it was amended in 1915[7] so as to make the inclusion of the agreement no longer necessary to secure such exemption.[8]

Thus the introduction of these agreements into mortgage notes was brought about by a statute, the long continued existence of which fixed its use firmly. If the agreement were still necessary to secure exemption, or were it purely meaningless, except to have given exemption under the above statute, it might well be argued that its use should not make a note non-negotiable. However, such is not the situation. The agreement is no longer necessary for exemption and while this was originally the primary reason for the inclusion of the agreement, it has had an additional effect. In cases where the amount of the mortgage note exceeds the assessed value of the property, it has required the mortgagee to bear the tax on such excess. The amount of this tax can never be accurately determined at the time of the execution of a note as the rate often varies from year to year, and according to the residence of the holder. Further, there is a possibility of new taxes being imposed after the execution of the note. So although the primary cause for the inclusion of the agreement no longer exists, this incidental effect, which clearly renders the sum uncertain, must be considered. Hence, such notes are non-negotiable.[9]

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[6] Conn. Gen. Stat. (1902) § 2349; *cf.* Conn. Gen. Stat. (1888) §§ 3854, 3855.

[7] Conn. Pub. Acts 1915, c. 125; Conn. Gen. Stat. (1918) § 1167.

[8] A vestige of the former exemption requirement still remains in Conn. Gen. Stat. (1918) § 1184, which in defining personal property subject to taxation says "but money secured by mortgage upon real estate in this state, when there is no agreement that the borrower shall pay the tax, shall be set in the list and taxed only in the town where said real estate is situated."

[9] As a matter of practice, mortgagees desiring negotiable notes should omit such agreements. If such an agreement is desired, it should be placed only in the mortgage, for (as pointed out by the court in the instant case) such inclusion does not affect the negotiability of the note. Des Moines Savings Bank v. Arthur, 163 Iowa, 205, 143 N. W. 556 (1913); Page v. Ford, 65 Or. 450, 131 Pac. 1013 (1913); Frost v. Fisher, 13 Colo. App. 322, 58 Pac. 872 (1899); Barker v. Sartori, 66 Wash. 260, 119 Pac. 611 (1911). Lenders accepting such notes as collateral, whose borrowers can not prevail upon the mortgagor to give a new note which is negotiable, should obtain an affidavit from the mortgagor that there are no existing defenses or equities. This would give the lender protection except possibly in cases of defenses or equities not then known to the mortgagor; for it is doubtful that a lending of money in reliance on the affidavit would create an estoppel against a mortgagor who was ignorant of an existing defense.

This portion of the opinion of the *Johnson* case seems sound (although it upsets nearly 75 years of settled practice)[10] but the ultimate decision of the court is hard to justify. It appears that on January 11, 1924, the defendant's mortgagee borrowed $8,000 from the plaintiff, giving his own note for the amount and collateral security. Part of the collateral was the defendant's mortgage and mortgage note; these were assigned to the plaintiff and the assignment recorded.[11] Later, on January 18, 1924, a further loan of $8,000 was made by the plaintiff to the mortgagee. During the following year the defendant made payments to the mortgagee amounting to $3,000 to be applied on the defendant's mortgage indebtedness. The mortgagee used these payments to reduce his indebtedness to the plaintiff, but these payments were not applied on the defendant's note. In January, 1925, the indebtedness of the mortgagee, originally evidenced by his notes of January 11 and 18, 1924, was consolidated into one note, and a new assignment of the defendant's mortgage and mortgage note was given to the plaintiff and recorded. Upon default of the mortgagee to pay the plaintiff, this action was brought to foreclose the mortgage held by the plaintiff as collateral, the mortgage note, given by the defendant, being due and no payments having been credited thereon. The lower court gave judgment for the plaintiff, treating the mortgage note as negotiable. On appeal, as above indicated, the note was considered non-negotiable, and it was held that the second assignment gave the defendant a power to set-off against the plaintiff any payments made prior to it, although such payments (made by defendant to his mortgagee) were subsequent to the first assignment.

A provision in a note that collateral has been deposited for

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[10] As the exceptions to the sum certain provision, specifically set forth in section 2 of the N.I.L., Conn. Gen. Stat. (1918) § 4360 do not include this situation, the rule of statutory construction, "*expressio unius est exclusio alterius*" might be applied. This, together with the fact that the holding makes for a uniform interpretation of a uniform act, gives it added weight.

[11] In most states recordation of an assignment of a mortgage and non-negotiable mortgage note is provided for by statute, and is generally considered sufficient notice to invalidate subsequent payments on the note to the mortgagee by a mortgagor's subsequent grantees. But many states, including California, Michigan, Minnesota, Montana, Illinois, Nebraska, New York, Oregon, Utah, Wisconsin and Wyoming, specifically provide that recordation is not sufficient notice to a mortgagor to invalidate such payments. Massachusetts and Pennsylvania have also interpreted their statutes in the same manner. However, a few states, including Indiana, North Dakota, South Dakota, New Jersey and Maryland, have either specifically provided otherwise or have reached that result by judicial decision. Connecticut does not specifically provide for such a situation by statute, and no direct holding on the point appears. See JONES, MORTGAGES (7th ed. 1915) § 480.

payment of "this or any other liability of —— to the payee" will allow the payee to apply such collateral to payment of other debts as well as the indebtedness it was given to secure.[12] So in the *Johnson* case, as there was a similar provision in each note given by the mortgagee to the plaintiff,[13] the defendant's mortgage and mortgage note became collateral for the entire $16,000 lent by the plaintiff. The new note given in January, 1925, was only a new form of evidence of the balance of the indebtedness, for which the mortgage and mortgage note were collateral, and which was originally evidenced by the notes of January 11 and 18, 1924, there being no subsequent credits given. As such, the new note merely operated to extend the time at which the indebtedness came due. In this situation, the collateral is not released, but remains continuously at the disposal of the payee.[14] So the giving of the second note could not have effected an equitable release of the first assignment. Nor was there any formal release. That assignment must, therefore, be considered as still valid and binding, as was indeed found by the trial court. The court recognized that notice of assignment creates a disability on the part of a mortgagor to discharge his indebtedness by making payments, on the mortgage note, to the mortgagee. Hence, it would seem that there should have been no set-off allowed in this case.[15]

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[12] Union Brewing Co. v. Interstate Bank & Trust Co., 240 Ill. 454, 88 N. E. 997 (1909); Commercial & Savings Bank v. Jenks Lumber Co., 194 Fed. 732 (N. D. Ohio, 1911); Merchants' Nat'l Bank v. Demere, 92 Ga. 735, 19 S. E. 38 (1894); Hanover Nat'l Bank v. Brown, 53 S. W. 206 (Tenn. 1899). The effect of the inclusion of such an agreement would seem very similar to that of an independent agreement as to the collateral. *Cf.* National Bank of Commerce v. Pettibone, 125 Wash. 607, 217 Pac. 505 (1923).

[13] The fact that the blank in such a provision is not filled in will not bar recovery under it. "In supplying omitted words, which the context clearly shows must be read in connection with it, to make the instrument the full expression of the manifest intention and understanding of the parties to it, the same is neither altered, varied, nor contradicted, but merely put in the shape in which it was intended it should be at the time it was executed." Oleon v. Rosenbloom, 247 Pa. 250, 93 Atl. 473 (1915); Beacon Trust Co. v. Robbins, 173 Mass. 261, 53 N. E. 868 (1899).

[14] "The principle is too well settled to need citation of authorities that the renewing of notes from time to time in no way extinguishes the original debt. It is simply an extension of the time of payment, and a change as to the evidence of the debt, and all the collaterals pledged for the payment would remain as security, not withstanding the extension of the time of payment," Holland Trust Co. v. Waddell, 75 Hun, 104, 113, 26 N. Y. Supp. 980, 986 (App. Div. 1st Dept. 1894), *aff'd* 151 N. Y. 666, 46 N. E. 1148 (1897). *Acc:* Pond v. Clarke, 14 Conn. 334 (1841); Collins v. Dawley, 4 Colo. 138 (1878); Wise v. Williams, 162 Fed. 161 (C. C. S. D. N. Y. 1908); Cotton v. Atlas Nat'l Bank, 145 Mass. 43, 12 N. E. 850 (1887); Pattillo v. Citizens Nat'l Bank, 197 S. W. 1054 (Tex. Civ. App. 1917).

[15] *Cf.* Mitchell v. Cook, 29 Barb. 243 (N .Y. 1859).

The court spoke of the second assignment as being part of a "new transaction." It apparently then proceeded on the notion, not sustained by authority in this situation, that for some infinitesimal time preceding the giving of the second assignment, the mortgagee was the complete owner of the mortgage. That being the case, the mortgagor's prior payments were deemed to apply on his note, so that the second assignment of the note as collateral was only of the balance yet unpaid by the defendant. But it seems strange to say that the second assignment, while it created no new beneficial rights in the assignee, operated to remove the disability created by notice of the first assignment.[16]

[16] If taking a new assignment in connection with an ordinary renewal is to be so treated, then the practice of taking second assignments in any case would seem inadvisable in Connecticut. Of course if the mortgage note is negotiable, and if it is taken in good faith, for value and before maturity, this difficulty does not arise. Otherwise, this decision makes it advisable to require an affidavit from the mortgagor whenever a second assignment is taken. Whether this should be required in cases where the first assignee sells to a second is not determined in the instant case.