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In the death of Richard Martin Paskus the Journal has lost an editor, and the members of the Board a close friend. We who came to know him were even more deeply impressed by the quiet sincerity of his personality than by the clear insight and honesty so characteristic of his work. The full measure of his contribution to the Journal those who did not know will never realize.

It is with deep regret that the Journal prints the following Comment as his final contribution.

THE "ILLEGAL" CREATION OF SHARES IN RETURN FOR NOTES*

Many state constitutions contain the following clause: "No corporation shall issue stock or bonds except for money paid, labor done or property actually received, and all fictitious in-

* The general subject matter of this comment has already been treated in an article particularly notable for a careful discussion of the Texas authorities. Waterman, *The Creation of Corporate Shares in Return for Promissory Notes* (1929) 7 TEX. L. REV. 215.

crease of stock or indebtedness shall be void."[1] When a corporation, in return for a note, attempts to create as to an individual some or all of the interests constituting that amorphous status, shareholdership, the interpretation of such a provision presents a difficult problem.

Whether the provision has any application to a specific case depends at least upon the answers to the questions: does the transaction amount to an "issue of stock," and is the note "money paid" or "property"? The latter question may be affected by various circumstances, *e. g.*, the presence of security for the note, the solvency of the maker, payment of the note, or the fact that the corporation has discounted the note with or without recourse.

The problem of whether the provision applies and, if so, what is to be its effect, arises under varied circumstances. Thus the corporation may bring two types of actions, and either may be affected by whether the litigation is controlled by the directors or by non-assenting shareholders. These actions may be to enforce payment of the note, or to cancel the shares in suits against either the original takers or bona fide transferees for value, with or without tender of the note in court, and before or after the note has been paid or payment tendered. Non-assenting shareholders or creditors may seek to enjoin the issue, or to recover damages from the directors for losses resulting from their "illegal" act. The original holder of the shares may bring the following suits, before or after he has paid the note or tendered cash to the corporation: he may seek to cancel the note in a suit against the corporation, creditors of the corporation, or holders in due course, and at the time of suit he may or may not tender the certificates into court for cancellation, and he may or may not be in a position to surrender them; he may on the other hand sue the directors or non-assenting shareholders to secure recognition of his interests in the corporation, and at the time of suit

[1] ALA. CONST. § 234; ARIZ. CONST. XIV, § 6; ARK. CONST. XII, § 8; CAL. CONST. XII, § 11; COLO. CONST. XV, § 9; DEL. CONST. IX, § 3; IDAHO CONST. XI, § 9; KY. CONST. § 193; LA. CONST. art. 266; MO. CONST. XII, § 8; MONT. CONST. XV, § 10; N. D. CONST. § 138; OKLA. CONST. IX, § 39; PA. CONST. XVI, § 7; S. C. CONST. IX, § 10; S. D. CONST. XVII, § 8; TEX. CONST. XII, § 6; UTAH CONST. XII, § 5; WASH. CONST. XII, § 6.

It is believed that the cited provisions are sufficiently similar to justify comparison of cases decided under them. In addition, comparison is made with cases decided under similar statutes, or statutes similar at least in that they have been held to prohibit the issue of shares for notes. For a discussion of the problems arising under similar requirements imposed by a Blue Sky Commission, see Comment (1930) 18 CALIF. L. REV. 149. Decisions under such provisions are for the most part analogous as to the parties protected and the difficulties of enforcement, but a provision less rigorous in its requirements, such as one requiring only a 10% cash payment, might well be more strictly enforced than one requiring payment of a larger percentage. But *cf.* Furlong v. Johnston, *infra* notes 10 and 11.

the corporation may or may not have discounted his note. The holder in due course may sue the maker on his note, or the corporation on its indorsement. A bona fide transferee of the shares may sue the corporation, represented either by the directors or the non-assenting shareholders, to compel his recognition as a shareholder, or for damages, and he may also sue his transferor or the directors for damages. Creditors of the corporation may sue the maker on the note, or the present holders of the shares on the theory that they are not full-paid.[2] It is not here intended to make an exhaustive list of the various ways in which the issue may be presented, but it is apparent that the mere wording of the provision quoted furnishes no definition of the transactions to which it was intended to apply and no clue as to what effect it should be given when applicable.[3]

A determination of persons intended to be protected and the risks against which they were to be guarded might be expected to furnish a suggestion of the result which should be reached. There are at least five groups whose interests might be served by requiring payment for shares to be made in cash rather than in some medium less liquid, secure, or fungible. These are: (1) those already shareholders in the corporation, to whose interest it is that the corporation obtain as much as possible for shares subsequently created; (2) those who may subsequently invest in shares relying upon the fact that shares listed as full-paid represent more than a possibility of the collection of their par value, or upon the fact that certificates so issued are not open to subsequent attack; (3) those who may extend credit relying upon the paid-in value of the shares; (4) creditors who became such prior to the creation of the shares in question and who are interested, as is the first group, in the successful management of the corporation; and (5) a group which has an interest in checking wild-cat enterprises by requiring that a corporation start business with some liquid capital or similar assets of determinable value which will assure to some extent its solvency and prosperity. Under modern conditions of interrelated economic organization the last group comprises the whole community.

But even if it be recognized that a particular transaction is one which contains unreasonable possibilities of harm to each of the above classes, it still is normally impossible for a court to handle the issues presented in a suit involving a transaction already executed without injuring one or more of those classes.

[2] A circumstance which might influence decisions but which apparently is not raised in the cases is whether the note is a demand or time note, and if a time note whether it extends beyond the period to which statutes sometimes limit unpaid subscriptions. *Cf.* TEX. COMP. STAT. (1928) arts. 1331, 1338.

[3] For a discussion of the lack of definite meaning of "void" as used in statutes, see Comment (1928) 37 YALE L. J. 362.

Consider, for example, the most common type of such suit. A corporation through its directors sues the maker on notes given in return for the creation of shares, in a jurisdiction whose constitution has been interpreted to prohibit the specific transaction. The maker defends on the ground that the transaction was illegal and that the notes are wanting in consideration, *i. e.*, that the "void" shares cannot be considered sufficient consideration. If the court enforces payment of the notes, the interests of those who are at present creditors or shareholders of the corporation will be protected so far as the particular transaction is concerned, as the maker of the note will not be allowed to avoid his obligation at their expense. On the other hand, the protection designed for future shareholders, creditors, and the general public will be removed, for if corporations can obtain the aid of the courts in collecting such notes, they will accept them for shares when it is impossible to get cash. It is not likely that the little used remedy of *quo warranto* will prove a great deterrent. Furthermore, should the corporation continue to take such risks in the future, injury may result even to the interests of those who are benefited by the immediate outcome of the suit. If recovery on the notes is denied, and the maker then asks for their cancellation, the court must further determine what affirmative relief it will grant a "guilty" party. To deny cancellation of the notes may leave it within the power of the corporation to collect the amount due by negotiating the notes to a holder in due course and creating as to him rights against the maker. Would such a result be desirable if the shares have been cancelled, or if in fact the directors were the only parties who realized the illegality of the original transaction?

It seems apparent that there are great difficulties in the way of an adequate solution of any one of the many problems here involved. Furthermore, the decision in every such case affects and is affected by the decisions in all the other suits to which the constitutional provision may be applied.[4] As a matter of fact the courts have generally protected the parties involved who had the least possibility of controlling the original transaction, *i. e.*, holders in due course, bona fide transferees, and creditors.[5] These

[4] It is obvious that in the simple case of the corporation suing the maker to enforce the note, a relevant inquiry is whether the shares created are subject to attack by the attorney-general, or in suits brought for the corporation by directors or non-assenting shareholders; whether the shares can be transferred so as to create in the transferee rights against the corporation; whether a holder in due course can collect the note; and whether the maker by payment or tender of payment can create in himself the rights of a shareholder. Among the most cogent reasons for more detailed legislation on this subject is the fact that a court in deciding the specific problem before it might easily fail to see all of the multitude of situations affected.

[5] See *infra* note 39.

decisions may be justified on grounds of fairness, or of the ineffectiveness of rendering prophylactic decisions against parties who are mere bystanders in the improper transaction. Yet the recognition of the rights of innocent parties necessarily diminishes the prohibitive effect of the provision, since each "guilty" party, although unable directly to receive that for which he bargained, can always benefit from the agreement indirectly, through his power, by transferring the instrument, to render it enforceable according to its tenor.[6]

In discussing the application of the constitutional provision and statutes in question, this comment will proceed in an order possibly more arbitrary than realistic. Those cases will first be discussed in which the question was raised of whether the provision applied at all; then those in which the court, having determined that the transaction was prohibited, was presented with the problem of enforcing the agreement according to its terms; and finally cases in which the courts were asked by the parties involved in an admittedly prohibited transaction for relief from certain liabilities arising therefrom.[7]

Is a note considered proper consideration for the "issue of shares" under a statute requiring "money paid" or "property"? It can at least be said that notes are not money, though they may be its equivalent, and that they are not necessarily "property," although statutory definitions of property not referring specifically to the provision here in question may include choses in

[6] There is sometimes an interesting discrepancy between the protection afforded the corporation as a whole and that extended to the innocent shareholders acting on behalf of the corporation. Compare the holdings in the suits against the makers of the notes in Bank of Commerce v. Goolsby, 129 Ark. 416, 196 S. W. 803 (1917), with those in Bank of Dermott v. Measel, 172 Ark. 193, 287 S. W. 1017 (1926) and Bank of Manila v. Wallace, 177 Ark. 190, 5 S. W. (2d) 937 (1928). Since the ultimate recovery in either type of action goes to the corporation, and thus to the guilty as well as to the innocent, to those who did not rely and those who did, is the distinction valuable? Was it consciously drawn? See Bank of Dermott v. Measel, *supra* at 196, 287 S. W. at 1018. A holding supporting the distinction is Pine River Bank v. Hodsdon, 46 N. H. 114 (1865). One way of achieving the distinction is by applying the doctrine of estoppel to bar suits by the original parties, who are presumed to know the law, or by anyone else who knew the facts, and permitting those without knowledge to bring such suits. See Ransome Concrete Machinery Co. v. Moody, 282 Fed. 29, 34 (C. C. A. 2d, 1922).

[7] Many of the cases may have been decided on either of two issues, and it is sometimes difficult to determine which was the real basis of the decision. Thus in Meholin v. Carlson, 17 Idaho 742, 107 Pac. 755 (1910), some of the justices placed their decision on the ground that a note was property, and others on the ground that the suit was by a receiver. Where decisions may have been based on either of two issues this comment tries to avoid citing the case as a direct holding on either point, unless it is expressly stated by the court to be such. *Cf.* General Bonding & Casualty Ins. Co. v. Moseley, *infra* note 18.

action.[8] This provision was designed to prevent the corporation from assuming the risk of never receiving par value for shares created or certificates issued. From the viewpoint of risk assumed, a note becomes the equivalent of "money paid" only after it has been paid or payment has been tendered,[9] or after it has been negotiated by the corporation without recourse at its face value. Accordingly, the courts tend to consider such notes valid consideration for shares after the corporation has received payment, even if not before.[10] Some courts have gone further and considered all notes which could be discounted the equivalent of cash payment at the moment when the corporation received cash, although the corporation, being secondarily responsible on the note because of its endorsement, still bore the risk of the maker's insolvency.[11] Such decisions can be justified only on the ground that the courts believed the question at issue to be, not whether the corporation was forced to run certain risks, but

[8] See Waterman, *op. cit. supra* star note, at 217, for opinions stated in such terms. It seems doubtful to the writer that any court, whatever its language, would feel that such definitions were controlling. See Cahall v. Lofland, *infra* note 41, at 317, 114 Atl. at 233.

[9] But *cf.* Lee v. Cameron, 67 Okla. 80, 169 Pac. 17 (1917); Waterman, *op. cit. supra* star note, at 231. Are the questions of the creation of shares for notes of a face value equal to par, and of the creation for some other consideration of a character permitted by statute but of a value less than par under a statute requiring payment of the par value, sufficiently analogous to make comparison valuable?

[10] Furlong v. Johnston, 239 N. Y. 141, 145 N. E. 910 (1924) (suit on note by holder with notice); Ramsay v. Crevlin, 254 Fed. 813 (C. C. A. 8th, 1918) (same); Conover v. Hasselman, 206 Iowa 100, 220 N. W. 42 (1928) (same); see Whitewater T. & P. Mfg. Co. v. Baker, 142 Wis. 420, 423, 125 N. W. 984, 986 (1910); Mills v. Friedman, 111 Misc. 253, 270, 181 N. Y. Supp. 235, 295 (Sup. Ct. 1920); *cf.* Haynes v. Kenosha Elec. R. R., 139 Wis. 227, 119 N. W. 568 (1909) (bonds).

[11] First Nat'l Bank v. Fulton, 156 Iowa 734, 137 N. W. 1019 (1912) (suit on note by holder with notice). In Conover v. Hasselman, *supra* note 10, the court apparently reasons that the defendant must pay his note because he became a shareholder; that he became a shareholder because the mode of payment was satisfactory; that the mode of payment was satisfactory because the indorsement of the corporation was of no significance; and that the indorsement was of no importance because the note is now being collected as against the maker. The decision in Furlong v. Johnston, *supra* note 10, was rendered after the repeal of the statute in question, when, since precedent as to future issues was not involved, the only question left was whether the "guilty" shareholder should be allowed to avoid his obligation. Contrast the decision in Re Waterloo Organ Co., 134 Fed. 341 (C. C. A. 2d, 1904). See Comment (1925) 10 CORN. L. Q. 504, 506, approving the logic of the Furlong case. A further difficulty may arise under such holdings if, as in the Furlong case and Lone Tree Bank v. Timmerman, 193 Iowa 1320, 188 N. W. 856 (1922), the corporation discounts the note at less than par, thus putting it out of its power to secure full payment for the shares created, although the maker may later be forced to pay a holder the face value of the note.

whether the corporation, even if actually borrowing in part on its own credit, did receive the required cash.[12]

Another circumstance under which it has been said that a note is "money paid" or "property" is where the note is due and collectible at the time suit is brought.[13] It is somewhat ridiculous to suppose that legislators would go to the trouble of specifically making bad notes unenforceable, or giving corporations the power to withdraw benefits conferred without consideration. The value of the provision, if it is intended to prevent the assumption of risks, is completely destroyed by a test which is generally based on circumstances arising only after the risk has been irretrievably assumed, since such a test furnishes no definite guide by which the officers or directors may determine, at the time of the proposed creation of the shares, whether the transaction will be in violation of the legislative prohibition.[14]

It is probably futile to discuss in the abstract whether notes are "property." Far more important is the question how far taking notes represents a greater risk than the corporation is permitted to assume under a provision making "property" valid consideration. The difference between notes received for shares and other types of property similarly acquired by a corporation is that any corporation in order to do business must take certain chances with respect to the type of property in which it is dealing, be it patents or mining claims, but most corporations are not necessarily forced to assume extensive banking risks by using promises to pay as basic capital. Notes may be of a less speculative value than patents, and yet the directors may be far less competent to deal with these lesser risks. Property to be used in the business must be purchased at some time and the risk of its value assumed, but it is hardly the function of every corporation to extend credit to its shareholders. In the case of banks and insurance companies, the very corporations most expert in dealing with such risks, the interest of the community in the stability of such enterprises is even more strongly opposed to the creation of a capital structure based upon promissory notes.[15]

The decisions reflect the uncertainty inherent in the legislative vagueness of language and purpose. Some courts allow shares to be created for unsecured notes, or at least for good unsecured notes.[16] Other courts deny the right to take unsecured notes,[17]

[12] But see Waterman, *op. cit. supra* star note, at 226.

[13] First Nat'l Bank v. Fulton, *supra* note 11.

[14] See dissent in Schiller Piano Co. v. Hyde, 39 S. D. 74, 81, 162 N. W. 937, 939 (1917).

[15] *Cf.* Prudential Life Ins. Co. v. Pearson, 188 S. W. 513 (Tex. Civ. App. 1916), *rev'd*, 222 S. W. 967 (Tex. Comm. App. 1920).

[16] Schiller Piano Co. v. Hyde, 39 S. D. 74, 162 N. W. 937 (1917) (suit on note by corporation); German Mercantile Co. v. Wanner, 25 N. D. 479, 142 N. W. 463 (1913), 52 L. R. A. (N. S.) 453 (1914) (same); Goodrich v.

but allow corporations to take notes sufficiently secured.[18] The difference between a secured and an unsecured note is, of course, not that one is "property" while the other is not, but that one will require the corporation to take fewer risks, since the collateral may have a definite market value, and in any case is security additional to the note. Only one court has been found which now holds that an adequately secured note may not be the required "property."[19] A note so secured is "property" for the purpose of placing resources in the hands of the corporation, but it may be pointed out that if the collateral were so good, the shareholder might have borrowed against it, paying the corporation in cash. The courts are forced, of course, to compromise between the desire for security and an equal desire to permit a flexible market for certain shares.[20]

A further problem is the formulation of a satisfactory definition of "issue of shares."[21] The constitutional provision can not definitely be said to prohibit all contracts to create shares if entirely executory.[22] How can such contracts of "subscription" be distinguished from the prohibited "issue of shares"? It is improbable that there is any one incident which distinguishes all shareholders from all subscribers. Some courts, such as Texas, have attempted to draw a distinction between the two which has not always been insisted upon even by the legislators.[23] In

Reynolds, 31 Ill. 490 (1863) (suit on note by holder with notice under statute requiring 10% payment in cash); Pacific Trust Co. v. Dorsey, 72 Cal. 55, 12 Pac. 49 (1887) (suit on note by corporation under statute requiring 10% payment, and forbidding banks to include promissory notes in statements of paid in capital); *cf.* Meholin v. Carlson, *supra* note 7.

[17] Kanaman v. Gahagan, 111 Tex. 170, 230 S. W. 141 (1921) (suit on note by promoter); Jones Drug Co. v. Williams, 139 Miss. 170, 103 So. 810 (1925) (suit on note by holder with notice); Alabama Nat'l Bank v. Halsey, 109 Ala. 196 (1895) (same); Southwestern Tank Co. v. Morrow, 115 Okla. 97, 241 Pac. 1097 (1925) (suit on note by corporation); Bank of Dermott v. Measel, *supra* note 6 (same); (1926) 10 MINN. L. REV. 536.

[18] General Bonding & Casualty Ins. Co. v. Moseley, 110 Tex. 529, 222 S. W. 961 (1920), *rev'g* 174 S. W. 1031 (Tex. Civ. App. 1915), and overruling previous Texas decisions. See Comment (1923) 1 TEX. L. REV. 306. *Contra:* Walz v. Oser, 93 N. J. Eq. 280, 116 Atl. 16 (1922) (weakened as authority by extreme facts and statute, 2 N. J. COMP. STAT. (1911) 1630); *cf.* Sohland v. Baker, 141 Atl. 277 (Del. 1927).

[19] Walz v. Oser, *supra* note 18. See North Dakota statute, cited *infra* note 45.

[20] Such issue may be necessary if new enterprises are to be supported in a frontier community. See Clark v. Farrington, 11 Wis. 306, 319 (1860).

[21] See Waterman, *op. cit. supra* star note, at 240.

[22] It has been suggested that in certain states a consistent interpretation of the constitution might require that decisions affecting the creation of shares be applied to agreements of "subscription" and payments by installments. Waterman *op. cit. supra* star note, at 239.

[23] Articles 1335 and 1339 of TEX. COMP. STAT. (1928) apparently use "subscriber" and "stockholder" interchangeably. For a similar confusion

determining whether or not a given transaction is legal, the significant factors seem to be the rights recognized by the corporation in the holder. There apparently is no doubt that if a corporation may accept a subscription, it may accept its rights under such a subscription in negotiable form.[24] It is impossible to state with accuracy what rights the corporation may not confer upon a "subscriber" without "issuing shares" to him within the meaning of the statute and thus outlawing the transaction. For example, "subscribers" have been allowed to vote, and share in dividends.[25] The element carrying most weight at present in Texas seems to be the issue of the certificate.[26] Such a line seems rather unfortunate, since it is neither mechanically easy to draw,[27] nor technically valid.[28] Interpreting the Texas law of

see German Mercantile Co. v. Wanner, *supra* note 16, at 482, 142 N. W. at 464.

[24] It was so held in the following suits on the notes by the corporation or holders with notice: Cope v. Pitzer, 166 S. W. 447 (Tex. Civ. App. 1914); Horn Bros. v. Baker, 173 S. W. 474 (Tex. Civ. App. 1914); Commonwealth Bonding & Cas. Ins. Co. v. Hollifield, 220 S. W. 322 (Tex. Comm. App. 1920), *rev'g* 184 S. W. 776 (Tex. Civ. App. 1916); Commonwealth Bonding & Cas. Ins. Co. v. Hill, 184 S. W. 247 (Tex. Civ. App. 1916); McCoy v. Bankers' Trust Co., 200 S. W. 1138 (Tex. Civ. App. 1918); Smith v. McAdams, 206 S. W. 955 (Tex. Civ. App. 1918).

[25] *Cf.* Cope v. Pitzer, *supra* note 24 (dividends payable to "subscriber"); Mitchell v. Porter, 223 S. W. 197 (Tex. Comm. App. 1920) ("subscriber" given vote); Davis v. Mitchell, 225 S. W. 1117 (Tex. Civ. App. 1920) (same). See German Mercantile Co. v. Wanner, *supra* note 16, at 489, 142 N. W. at 467; dissent of Huff, C. J., in Cattlemen's Trust v. Swearingen, *infra* note 26, at 602.

[26] *Cf.* Kanaman v. Gahagan, *supra* note 17; Cattlemen's Trust Co. v. Swearingen, 200 S. W. 596 (Tex. Civ. App. 1918); McCoy v. Bankers' Trust Co.; Commonwealth Bonding & Cas. Ins. Co. v. Hill; Horn Bros. v. Baker; Smith v. McAdams, all *supra* note 24. See Waterman, *op. cit. supra* star note, at 220 *et seq.*

[27] The question becomes complicated when the corporation, though "issuing" the certificate, retains some control over it till the note is paid. That the line is indistinct may be seen by comparing Commonwealth Bonding & Cas. Ins. Co. v. Hill, *supra* note 24, with Cattlemen's Trust Co. v. Swearingen, *supra* note 26; and Kanaman v. Gahagan, *supra* note 17, with Farmers' and Merchants' State Bank v. Falvey, 175 S. W. 833 (Tex. Civ. App. 1915). In General Bonding & Casualty Co. v. Moseley, *supra* note 18, it was apparently conceded that the transaction amounted to an "issue of shares," yet it seems doubtful how far the facts differ from those in Kanaman v. Gahagan, *supra* note 17.

[28] It has been said that the right to a certificate is not a conclusive incident of shareholdership. BALLANTINE, PRIVATE CORPORATIONS (1927) 415. The distinction which the Texas court has made has received the approval of the UNIFORM BUSINESS CORPORATION ACT § 16 and of Waterman, *op. cit. supra* star note, at 240, but possibly chiefly on the ground that publicity of accounts is of far more importance than the protection of the paid in value of shares. The Texas court might not accept this assumption. It has been suggested that those who before incorporation agree to become shareholders are "subscribers," and that those later con-

corporations as a body, it is apparent that it requires at least 50% of the authorized shares to be paid for in full before the corporation files its articles of association, and the remainder to be subscribed and paid for within two years.[29] It might well be necessary to insist only that the corporation include no shares in the 50% paid-up for which it has in fact received only notes. Since subscriptions of some sorts are allowed for the remaining 50%, it should make comparatively little difference what rights the corporation recognizes in these subscribers if the nature of the transaction is apparent on the books. Quibbling about the issue of certificates to subscribers for the last 50% may result in a great deal of trouble in securing subscribers and collecting subscriptions, without protecting the creditors of the corporation, those who may extend credit, shareholders, or persons who may later purchase shares. While such a system of regulation would be unprecedented in Texas, and would require a change in the interpretation of the constitution, it is an interpretation very similar to that which has been made in California,[30] and the Texas court has already proved itself willing to reverse its interpretation.[31]

The effect of drawing a distinction between "shareholders" and "subscribers" in this respect is that in suits between the parties each is put in the position either of basing a right of action upon the fact that benefits have been received from the other party, or of repudiating an accepted agreement.[32] Thus, in a suit to cancel shares issued for notes the corporation alleges that it has always treated this individual as a shareholder, and that since the statute prohibits the creation of shares for such consideration, the corporation is not merely privileged, but also under a duty, no longer to recognize him as a shareholder. The maker, on the other hand, when he sues to recover his notes, alleges that he has received from the corporation contrary to statutory prohibitions, various benefits belonging only to shareholders such as voting rights, dividends, or a certificate, and that the entire transaction being therefore tainted with "illegality," his note is without consideration and therefore unenforceable. The defenses are equally paradoxical, since the corporation defends on the suit to recover the note by alleging that it has really extended few and tenuous rights, and the maker of the note, in a suit by the corporation to cancel the shares, defends on the

tracting to "purchase" shares should be considered "shareholders." See Guaranty Mtge Co. v. Wilcox, 62 Utah 184, 192, 218 Pac. 133, 136 (1923).

[29] TEX. COMP. STAT. (1928) arts. 1308, 1331, 1338.

[30] See Comment (1930) 18 CALIF. L. REV. 149.

[31] Washer v. Smyer, 109 Tex. 398, 211 S. W. 985, 4 A. L. R. 1320 (1919); General Bonding & Casualty Ins. Co. v. Moseley, *supra* note 18.

[32] See cases cited *supra* notes 24, 25, 26, 27 for the pleading problems described in this paragraph.

ground that the transaction has really yielded him nothing substantial. In a suit on the note, the maker defends by alleging that he has received the incidents of shareholdership, and in a suit to compel recognition of the shares the corporation alleges in defense that since the plaintiff has always been treated as a shareholder, he has no right to remain one. The illogical results of such pleadings drive courts to expressions of distaste,[33] and to a use of the doctrine of estoppel against whichever party they deem more culpable.[34]

One possible solution to this difficulty is a decision that the corporation can disregard the note and sue on the subscription.[35] Expedient as this might be if the court has little belief in the necessity of enforcing the constitutional provision, it is open to a logical objection in that, if the contract was one of subscription merely, the suit could be maintained on the note, but if the contract was for the immediate creation of shares, there is no contract of subscription, but merely an illegal transaction which it is beyond the power of the corporation to perform or to enforce.[36]

When a court has decided that a given transaction is an attempt at the prohibited creation of shares for neither money received nor property, what will be the effect of such a decision when the problem is raised in the various ways indicated above? A few cases have held that the word "void" as used by the constitution forced a decision that no action could be brought by the holder in due course of the note against the makers.[37] Decisions of this type penalizing the helpless creditors, bona fide transferees, and holders in due course have not been generally approved, and have in some cases been overruled.[38] The trend of

[33] See Goodrich v. Reynolds, *supra* note 16, at 496.

[34] The doctrine of estoppel was invoked in the following cases: Schiller Piano Co. v. Hyde, *supra* note 14; Joy v. Godchaux, 35 F. (2d) 649 (C. C. A. 8th, 1929); Davis v. Mitchell, *supra* note 25; Thompson v. First State Bank, 109 Tex. 419, 211 S. W. 977 (1919); Goodrich v. Reynolds, *supra* note 16; McCallum v. Wing, 30 F. (2d) 305 (C. C. A. 1st, 1929); Central Co. v. Mulroney, 196 Iowa 38, 194 N. W. 295 (1923). In the individual cases the use of this method of carrying out the court's sense of justice may be justified, but a court's ethical standards furnish little basis for prediction.

[35] Boldt v. Motor Securities Co., 74 Colo. 55, 218 Pac. 743 (1923); see Mitchell v. Porter, 223 S. W. 197, 201 (Tex. Comm. App. 1920); Washer v. Smyer, *supra* note 31, at 409, 211 S. W. at 989.

[36] Baird v. Kilene, 53 N. D. 244, 205 N. W. 681 (1925). But see Waterman, *op. cit. supra* star note, at 221. Could the corporation disregard the note and sue on the subscription if the note were not yet payable? See German Mercantile Co. v. Wanner, *supra* note 16, at 484, 142 N. W. at 465.

[37] Republic Trust Co. v. Taylor, 184 S. W. 772 (Tex. Civ. App. 1916); Prudential Life Ins. Co. v. Smyer, 183 S. W. 825 (Tex. Civ. App. 1916); Ater v. Rotan Grocery Co., 189 S. W. 1106 (Tex. Civ. App. 1916); see Lake St. El. R. R. Co. v. Ziegler, 99 Fed. 114, 128 (C. C. A. 7th, 1900).

[38] Washer v. Smyer, *supra* note 31.

the modern decisions is toward recognition of the invalidity of the transaction as a bar only to actions brought by the original parties or holders with notice.[39] The effect of such decisions, of course, is to render it easier for the "guilty" parties to carry out the transactions by selling the instruments exchanged. It is this result against which the Texas court attempts to guard by penalizing the issue of the share certificates.

The final question arises after it has been determined that the shares or notes are unenforceable in the hands of the present holders. What relief will the courts afford the "guilty" parties from the potential liability represented by the power to transfer such instruments to bona fide transferees? It is unfortunately impossible to render such a transaction, once executed, "void" in the sense that these outstanding instruments will have no effect.[40] Courts therefore entertain suits by the original parties to cancel the instruments in the hands of the other party, or of holders with notice.[41] Further questions may be raised if the maker of the note attempts to perfect the transaction by tender of payment,[42] or if either party attempts to cancel without tendering the instrument he has received.[43]

For the resulting confusion, which may be worse in its effect on corporate finance than the credit transaction sought to be

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[39] Collection of note by holder in due course: Washer v. Smyer, *supra* note 31; Hamilton-Turner Grocery Co. v. Hander, 299 S. W. 848 (Tex. Comm. App. 1927); Wilson v. Spencer, 261 Fed. 357 (C. C. A. 5th, 1919); Bank of Manila v. Wallace, *supra* note 6.

Collection of note by receiver in bankruptcy for corporation: Meholin v. Carlson, *supra* note 7; Mitchell v. Porter, *supra* note 35; Joy v. Godchaux, *supra* note 34; Smoot v. Perkins, 195 S. W. 988 (Tex. Civ. App. 1917); Allen v. Edwards, 93 Miss. 719, 47 So. 382 (1908); Thompson v. First State Bank, *supra* note 34. *Contra:* Gridley v. Tilson, 202 Cal. 748, 262 Pac. 322 (1927); Terrell v. Warten, 206 Ala. 90, 89 So. 297 (1921); *cf.* Goodyear v. Meux, 143 Tenn. 287, 228 S. W. 57 (1921); Clark v. Hamilton, 217 Fed. 229 (C. C. A. 8th, 1914). See Waterman, *op. cit. supra* star note, at 235.

As to the rights of bona fide transferees for value of the share certificates, see RESTATEMENT OF THE LAW OF BUSINESS ASSOCIATIONS (Am. L. Inst. 1928) § 23, stating that such persons become shareholders.

[40] See Comment (1928) 37 YALE L. J. 362.

[41] Suit to cancel notes: Prudential Life Ins. Co. v. Pearson, 188 S. W. 513 (Tex. Civ. App. 1916), *rev'd* on other grounds, 222 S. W. 967 (Tex. Comm. App. 1920); Southwestern Tank Co. v. Morrow, *supra* note 17; Lone Star Life Ins. Co. v. Pierce, 200 S. W. 1104 (Tex. Civ. App. 1918); General Bonding & Cas. Ins. Co. v. Moseley, *supra* note 18, *rev'd* on other grounds, 110 Tex. 529, 222 S. W. 961 (1920). *Contra:* Domenigoni v. Imperial Livestock Co., 189 Cal. 467, 209 Pac. 36 (1922); *cf.* Thronson v. Universal Mfg. Co., 164 Wis. 44, 159 N. W. 575 (1916). Suit to cancel shares: Sohland v. Baker, *supra* note 18; *cf.* Cahall v. Lofland, 12 Del. Ch. 299, 114 Atl. 224 (1921).

[42] See *supra* note 10.

[43] See Cahall v. Lofland, *supra* note 41, at 318, 114 Atl. at 234.

prevented, there are two possible remedies. One is to leave the enforcement of these statutory provisions to the state, and allow the parties to contract as they choose, with discretion in the attorney-general as to prosecution. This by itself would probably allow corporations great latitude in creating shares for notes.[44] Any further measure is based on the assumption that behind these statutory provisions there is a sound economic policy. If it is possible by one means or another to circumvent the statute, if the directors have a wide discretion as to such issues, and if an elastic method of marketing is desirable, then the solution is to make the directors and officers responsible to the same extent as indorsers upon all notes received in payment for shares.[45] This is no panacea; it would still leave the wavy line between shareholders and subscribers,[46] but it might have the effect of forcing the directors either to make more than a casual inspection of the notes and collateral, or to refrain from creating shares for notes. Both security and flexibility within limits laid down by the attorney-general might thus be achieved.

Underlying the entire problem of enforcement is the economic question of the real value of the provision when enforced. If all business enterprises could be run on liquid capital they would no doubt be more prosperous. This fact, however, is quite apparent to directors, and where they can get cash for shares it will no doubt be sufficiently to their interest to do so.[47] But should the corporation which cannot sell its shares for cash be allowed to market them as best it can, for notes? The question is far too general—there is, of course, no such thing as *the* corporation, or a community need for *a* corporation. But the community may need a railroad or other public utility, and be willing to take certain chances with respect to their financial structures in order to secure the undoubted advantages of their operation.[48]

The entire system of regulation designed to insure that a corporation receive or maintain the par value of its shares will be of little aid to creditors if the venture is unsuccessful. Thus, in

[44] But see HANDBOOK OF NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS (1927) 823.

[45] *Cf.* N. D. COMP. LAWS ANN. (1913) §§ 4528, 4529; MASS. GEN. LAWS (1921) c. 156, §§ 16, 36. Cases suggesting such responsibility are rare. *Cf.* Bank of Commerce v. Goolsby, *supra* note 6; Cochrill v. Abeles, 86 Fed. 505 (C. C. A. 8th, 1898).

[46] In German Mercantile Co. v. Wanner, *supra* note 16, the court evaded such a statute by calling the transaction a subscription, after first deciding that it was sufficiently an "issue of shares" to have come within the constitutional prohibition had the notes not been considered the "property" required by the constitution.

[47] This statement fails to take into account cases in which the directors issue shares to themselves or their adherents in return for notes in order to retain control of the corporation. *Cf.* Cahall v. Lofland, *supra* note 41.

[48] See *supra* note 20.

the case of the provision herein discussed, cash or notes when invested in an unproductive oil well are about of equal value. Once either has been used to purchase fixed assets, the receipt of par value may not protect creditors, except insofar as it frees the corporation from certain claims arising out of the indorsement of bad notes. But if the par value received has been sunk in a dry oil well, the creditors' dividend will be so small that a few bad notes will hardly matter. It may also be said that the system of regulation discussed has been tacitly repudiated to some extent in those states permitting the issue of shares without par value.

A further objection to the emphasis which statutes of this type lay upon insuring the receipt of par value is based on the absence of reliance.[49] How many creditors judge an old established business on the basis of what was paid for its shares? How many old established concerns are forced to sell shares for notes? If new corporations are most likely to infringe these statutes, will not the transaction be so apparent on their books and reports that many prospective creditors and purchasers of shares will be warned? Is not a requirement of such publicity of accounts, rather than an absolute prohibition of these transactions, the remedy? [50]

It can at least be said that the statutory provision with which this article commences, unless made both more detailed and flexible by further legislation, is quite unworkable. All corporations should not necessarily be treated alike; a regulation of this type laid down by the Blue Sky Commission may be wise but a blanket provision foolish.[51] It may further be said that legislatures in framing provisions limiting the creation of shares should be careful to specify the legal consequences of attempts to violate such provisions and not leave courts to struggle with a large and complex problem on the facts of a single case.[52]

RICHARD MARTIN PASKUS.

EXTERRITORIAL RECOGNITION OF INJUNCTIONS AGAINST SUIT

It is well settled [1] that a court of equity may, within its discretion,[2] issue an injunction forbidding a plaintiff to sue in a

[49] See Waterman, *op. cit. supra* star note, at 442.

[50] The UNIFORM BUSINESS CORPORATION ACT (1927) § 18 provides for such publicity.

[51] See BALLANTINE, *op. cit. supra* note 28, at 663.

[52] It is for the lack of such specific provisions that the writer would particularly criticize the UNIFORM BUSINESS CORPORATION ACT, *supra* note 50.

[1] Cole v. Cunningham, 133 U. S. 107, 10 Sup. Ct. 269 (1890); Weaver v. Alabama Great So. Ry., 200 Ala. 432, 76 So. 364 (1917); Missouri Pacific Ry. v. Harden, 158 La. 889, 105 So. 2 (1925); HIGH, INJUNCTIONS (4th ed. 1905) § 106; STORY, EQUITY JURISPRUDENCE (13th ed. 1886) §§ 899, 900; POMEROY, EQUITABLE REMEDIES (3d ed. 1905) § 670.

[2] *Cf.* Pound, *The Progress of the Law* (1920) 33 HARV. L. REV. 420, 426: "Undoubtedly a state may coerce its citizens not to sue abroad.

foreign state. And the authority to pronounce such a decree carries with it the power to punish disobedience through contempt proceedings.[3] But to a defendant, seeking relief from a vexatious foreign suit, the issuance of the injunction and the threat of negative "enforcement" are of no more than contributory importance. His ultimate concern is with the positive prohibitive effectiveness of the injunction in preventing the foreign suit. This effectiveness is dependent upon the active recognition which will be accorded the injunction by the courts of the sister state when the plaintiff disobeys the decree and attempts to sue.[4]

The problem would be easy of solution if, as has been suggested,[5] injunctions against suit were granted the automatic exterritorial recognition under the "full faith and credit" clause [6] of the Federal Constitution which is considered obligatory with some other types of equitable decrees.[7] But in the absence

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It does not follow, however, that its courts of equity . . . ought to exercise such jurisdiction in every case where it exists. We have to ask: What are the legal rights of the plaintiff in equity, defendant abroad, and are the legal remedies which are open to him adequate to maintain those rights? We have then to ask, is the injustice and hardship upon the plaintiff such as to make it expedient for equity to act, in view of the delicate considerations involved in interference with legal proceedings in other states?"

For judicial consideration of the discretional angle, compare the opinion in Folkes v. Georgia Central Ry., 202 Ala. 376, 80 So. 458 (1918) (denying injunction), with that in Northern Pacific Ry. v. Richey and Gilbert, 132 Wash. 526, 232 Pac. 355 (1925) (granting injunction). And see (1919) 28 YALE L. J. 503.

[3] See State ex rel. Bossung v. District Court, 140 Minn. 494, 498, 168 N. W. 589, 591 (1918); Union Pacific R. R. v. Rule, 155 Minn. 302, 305, 193 N. W. 161, 162 (1923).

[4] See Note (1919) 1 A. L. R. 148.

[5] (1923) 33 YALE L. J. 95, 96.

[6] U. S. CONSTITUTION Art. IV, § 1: "Full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state. And Congress may . . . prescribe the manner in which . . . [they] shall be proved, and the effect thereof."

[7] Equitable decrees entitled to exterritorial recognition under the "full faith and credit" clause include:

(a) Those for the payment of a specific sum of money. Lynde v. Lynde, 181 U. S. 183, 21 Sup. Ct. 555 (1901); Sistare v. Sistare, 218 U. S. 1, 30 Sup. Ct. 682 (1910); 2 BLACK, JUDGMENTS (1891) § 869; 1 COOK, CASES ON EQUITY (1923) 329n.

(b) Certain decrees concerning the conveyance of land. Burnley v. Stevenson, 24 Ohio St. 474 (1873). And see on this general subject Barbour, *The Extra-territorial Effect of the Equitable Decree* (1919) 17 MICH. L. REV. 527; Lorenzen, *Application of Full Faith and Credit Clause to Equitable Decrees for the Conveyance of Foreign Land* (1925) 34 YALE L. J. 591; Goodrich, *Enforcement of a Foreign Equitable Decree* (1920) 5 IOWA L. BULL. 230.

(c) Divorce decrees, within certain limitations. Atherton v. Atherton, 181 U. S. 155, 21 Sup. Ct. 544 (1901); *cf.* Haddock v. Haddock, 201 U. S. 562, 26 Sup. Ct. 525 (1906).

of specific constitutional or statutory designation and of any direct ruling by the Supreme Court on the point,[8] such recognition has not been accorded as a matter of course. Even those courts which have summarily dismissed suits brought under the shadow of a foreign injunction have not felt themselves forced to such action by the "full faith and credit" clause.[9] The opinion of two dissenting justices, in one of the leading cases allowing suit,[10] seems to be the only judicial argument for obligatory recognition, under the Constitution, of foreign decrees against suit.

The question thus resolves itself to one of a discretionary nature. Should a state, even though it need not, close its courts to a plaintiff who has been forbidden to sue by the judicial edict of another state? The apparent answer of the cases has been in the negative. A majority of the rulings on the point have allowed the disobedient plaintiff to sue.[11] But it is submitted that a critical analysis of the holdings will show the numerical

[8] All-inclusive dicta are common. A recent and typical Supreme Court expression is voiced by Sanford, J., in Roche v. McDonald, 275 U. S. 449, 451, 48 Sup. Ct. 142, 143 (1928): "It is settled by repeated decisions of this Court that the full faith and credit clause of the Constitution requires that the judgment of a State court which had jurisdiction of the parties and the subject-matter in suit, shall be given in the courts of every other State the same credit, validity and effect which it has in the State where it was rendered and be equally conclusive upon the merits; . . ."

Compare an even stronger statement made by a lower federal court in Beal v. Carpenter, 235 Fed. 273, 279 (C. C. A. 8th, 1916): ". . . the Supreme Court has conclusively determined that in a suit upon a judgment or decree of the court of another state the same credit and effect must be given to it by the court in which suit upon the judgment or decree is brought as would be given to it in the foreign state . . ." But cases cited in support of this proposition refer only to decrees for the payment of money.

[9] Fisher v. Pacific Mutual Life Ins. Co., 112 Miss. 30, 72 So. 846 (1916); Allen v. Chicago, Great Western R. R., 239 Ill. App. 38 (1925).

[10] Union Pacific R. R. v. Rule, *supra* note 3, at 306, 193 N. W. at 162.

[11] Cases permitting suit: Nichols & Shepard Co. v. Wheeler, 150 Ky. 169, 150 S. W. 33 (1912) (Tennessee interlocutory decree held no bar without discussion); State ex rel. Bossung v. District Court, *supra* note 3; Frye v. Chicago R. I. & P. Ry., 157 Minn. 52, 195 N. W. 629 (1923), certiorari denied, 263 U. S. 723, 44 Sup. Ct. 231 (1924); Union Pacific R. R. v. Rule, *supra* note 3; Kepner v. Cleveland, C. C. & St. L. Ry., 15 S. W. (2d) 825 (Mo. 1929) (evidence of foreign injunction rejected); *cf.* Hovel v. Minneapolis & St. L. Ry., 165 Minn. 449, 206 N. W. 710 (1926); Chicago R. I. & P. Ry. v. Lundquist, 206 Iowa 499, 221 N. W. 228 (1928).

Cases rejecting suit: Fisher v. Pacific Mutual Life Ins. Co.; Allen v. Chicago Great Western R. R., both *supra* note 9; *cf.* Gilman v. Ketcham, 84 Wis. 60, 54 N. W. 395 (1893) (foreign injunction against creditors, in dissolution proceedings, held to give receiver preferential claim when creditor attempts to garnishee a debt).

answer to be an illusory one, inasmuch as the decisions seem largely to be affected by considerations and factors outside the purely discretionary problem.

State ex rel. Bossung v. District Court,[12] the leading case allowing suit, is a Minnesota case, and its decision is based primarily on a line of Minnesota decisions[13] holding that, under the equal "privileges and immunities" clause[14] of the Federal Constitution, it is not within the discretion of a state court to refuse jurisdiction to a non-resident which would be granted to a resident plaintiff, no matter how cogent may be the reasons of policy[15] which may seem to make the granting of the privilege undesirable. The court argues that, inasmuch as no foreign injunction could force the court to close its doors to a resident of Minnesota, it may not discriminate to the extent of recognizing the injunction against a foreign suitor.[16] The "equal privileges and immunities" clause, as previously interpreted by the Minnesota courts, is thus held controlling, although the "full faith and credit" clause would seem to tend toward an opposite result. In view of a recent Supreme Court holding that a discretionary refusal of jurisdiction to a non-resident is not a denial of constitutional privileges,[17] the argument of the *Bos-*

[12] *Supra* note 3. In this case, the plaintiff was seeking a writ of mandamus to compel the Minnesota court to proceed with an action in which the plaintiff was suing as administrator of a person killed in Nebraska. Both parties to the original suit were residents of Iowa. The defendant railroad had secured a temporary injunction in Nebraska restraining the plaintiff from proceeding in Minnesota. The lower Minnesota court had then stayed the proceedings until final hearing on the Nebraska injunction. But on appeal mandamus issued, it being considered immaterial whether the Nebraska injunction should be made permanent or dissolved.

[13] The leading cases are State ex rel. Prall v. District Court, 126 Minn. 501, 148 N. W. 463 (1914) and Davis v. Minneapolis, St. P. & S. Ste. M. R. R., 134 Minn. 455, 159 N. W. 1084 (1916).

[14] U. S. CONSTITUTION Art. IV, § 2 (1): "The citizens of each state shall be entitled to all privileges and immunities of citizens in the several states."

[15] Among the most obvious are annoyance and expense caused the defendant, and waste of the court's time and resources, leading to crowded dockets, and the burdening of local taxpayers. See Comment (1930) 39 YALE L. J. 388, 398 *et seq.* and notes.

[16] Cassoday, C. J., in Eingartner v. Illinois Steel Co., 94 Wis. 70, 68 N. W. 664 (1896), employs an ingenious dialectic to evade the application of the above clause to force jurisdiction of suits by non-residents. He reasons that, inasmuch as one state can not grant its citizens the privilege to sue in *another* state, therefore it need not grant a citizen of the other state the *corresponding* privilege of suit in a state of which he is not a citizen.

[17] Douglas v. New York, N. H. & H. R. R., 279 U. S. 377, 49 Sup. Ct. 355 (1929). The court upheld a distinction between "residence" and "citizenship" as a basis for refusing jurisdiction of a suit under a New York statute. This distinction had previously been supported by some state courts. Central R. R. & Banking Co. v. Georgia Co., 32 S. C. 319, 11 S. E. 192 (1890); Hatfield v. Sisson, 28 Misc. 255, 59 N. Y. Supp. 73

sung case is no longer persuasive. A lower Minnesota court has already contravened the long-standing Minnesota rule by refusing to entertain a series of vexatious suits by non-residents.[18]

Later cases in Minnesota and elsewhere, allowing suit in the face of a foreign injunction,[19] have merely cited the *Bossung* decision as controlling or desirable, in refusing to apply the "full faith and credit" clause. The further argument was advanced in one case [20] that, since the United States Supreme Court had determined [21] that the clause in question did not require Tennessee to recognize an Alabama statute denying a claimant's right to sue outside Alabama, therefore an Iowa injunction against foreign suit was not necessarily entitled to recognition in Minnesota. But from the discretionary angle, the specific decree of an equity court with the parties before it might well be granted readier exterritorial recognition than the blanket decree of a legislature.[22]

More important than a refutation of the arguments advanced in refusing recognition of the foreign injunctions is consideration of the fact that the actual decisions were apparently made not only in spite of the injunctions but in complete disregard of them. Thus the Minnesota court decided the *Bossung* case as though the injunction had never existed. It reasoned, and the courts in the later cases reasoned correspondingly,[23] that, inasmuch as the Minnesota rule forced the court to entertain

(Sup. Ct. 1899); Loftus v. Pennsylvania R. R., 107 Ohio St. 352, 140 N. E. 94 (1923). And the Supreme Court had sustained such a distinction for other purposes. La Tourette v. McMaster, 248 U. S. 465, 39 Sup. Ct. 160 (1919); Maxwell v. Bugabee, 250 U. S. 525, 40 Sup. Ct. 2 (1919). For discussions of this point, see Hansell, *The Proper Forum for Suits Against Foreign Corporations* (1927) 27 COL. L. REV. 12, 16; Blair, *The Doctrine of Forum Non Conveniens in Anglo-American Law* (1928) 28 COL. L. REV. 1, 3; Note (1928) 41 HARV. L. REV. 387; Note (1928) 28 COL. L. REV. 347; (1903) 17 HARV. L. REV. 54

[18] The decisions were made by Judge Senn of Steele County, and were noted in the New York Sun, Oct. 18, 1929, at 28.

[19] See cases cited *supra* note 11.

[20] Union Pacific R. R. v. Rule, *supra* note 3.

[21] Tennessee Coal, Iron, & R. R. Co., v. George, 233 U. S. 354, 34 Sup. Ct. 587 (1914).

[22] See Comment (1924) 22 MICH. L. REV. 469, 472. And *cf.* Hovel v. Minneapolis & St. L. Ry., *supra* note 11, in which the premise and conclusion of the argument in the Rule case were reversed, the court reasoning that since an injunction forbidding suit has no exterritorial effect, *a fortiori* as to a statute.

[23] It is significant that Missouri, which followed the Bossung decision in Kepner v. Ry., *supra* note 11, has long had a rule, similar to the Minnesota rule, denying its courts the privilege to refuse jurisdiction to non-residents, because of the equal "privileges and immunities" clause. State ex rel. Pacific Mutual Life Ins. Co. v. Grimm, 239 Mo. 135, 143 S. W. 483 (1911); Gold Issue Mining & Milling Co. v. Pennsylvania Fire Ins. Co., 267 Mo. 524, 184 S. W. 999 (1916).

such a suit by a non-resident, therefore the instant non-resident was entitled to sue.[24] The non-recognition of the injunction was merely incidental. The basic reason of the decision would have been precisely the same had the defendant presented his arguments against the foreign suit directly to the Minnesota court instead of presenting that court with an injunction presumably based on those arguments.

Even in the two cases dismissing suit,[25] although the courts speak of the "comity" of recognizing the injunction of a sister state, the actual decisions seem to rest on broader grounds. In *Allen v. Chicago Great Western R. R.*,[26] the Illinois court is primarily concerned with denying the applicability of the "privileges and immunities" clause to force jurisdiction of the suit upon it; and the mention of the apparently vexatious nature of the suit, almost in justification of the granting of the Iowa decree, leads inevitably to the conclusion that the court would have reached the same decision by the same implicit reasoning had the defendant protested the Illinois jurisdiction without the aid of an Iowa injunction. And in *Fisher v. Pacific Mutual Life Ins. Co.*,[27] the Mississippi court recognized the Tennessee decree as a matter of comity, only in that it refused to question the correctness of the Tennessee finding as to the desirability of prohibiting suit in Mississippi—a recognition which implies as

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[24] In Dobson v. Pearce, 12 N. Y. 156 (1854), the Connecticut court had enjoined the plaintiff from suing on a judgment, on the ground that it was fraudulent. The plaintiff brought suit in New York regardless. The New York court, in deciding for the defendant, held that the Connecticut judgment was conclusive as to the fraud, but said: "The decree of the court of chancery of the state of Connecticut as an operative decree, so far as it enjoined and restrained the parties, had and has no extraterritorial efficacy, . . ." The older New York rule, like the Minnesota and Missouri rules, did not permit a discretionary refusal of jurisdiction to a non-resident. McIvor v. McCabe, 26 How. Pr. 257 (N. Y. 1863); Dewitt v. Buchanan, 54 Barb. 31 (N. Y. 1868).

[25] Fisher v. Pacific Mutual Life Ins. Co.; Allen v. Chicago Great Western R. R., both *supra* note 9.

[26] *Supra* note 9. Here the plaintiff, a resident of Iowa, had started suit in Iowa on a transitory cause of action arising there. He subsequently began suit in Illinois. The defendant asked the Illinois court for a continuance because of a prior Iowa decree enjoining suit by the plaintiff in Illinois. On appeal, the decision of the lower court was reversed and the continuance granted.

[27] *Supra* note 9. The plaintiff brought suit in Mississippi on an insurance policy drawn up in Tennessee between the plaintiff's decedent, who was a citizen of Tennessee, and the defendant, which was doing business there. The insured had died from injuries received in Tennessee. Previous to this action in Mississippi, the plaintiff had been prosecuting suit for several years in Tennessee. An injunction issued in Tennessee restraining the plaintiff from suing in Mississippi. On appeal, the Mississippi court affirmed a dismissal of the Mississippi suit.

its basis not the formal decree itself but the facts which must be assumed as underlying the decree.

The discretionary recognition of the foreign decree thus becomes entirely merged in the larger question of discretionary entertainment of suit by a non-resident.[28] This latter problem, involving conflicting rules of law and countless considerations of policy, has been adequately treated elsewhere.[29] It will suffice here to indicate that, in the reported cases, the larger problem has exerted so overpowering an influence that the effect of the foreign injunction against suit has been negligible in its direct bearing on judicial action. But the argument advanced in the *Fisher* case, that principles of comity should at least dictate an acceptance of the conclusion of the foreign court as to the advisability of allowing the suit in question, is convincing. There is no reason why the courts of one state should question the discretionary judgment of the court of a sister state, particularly when a remedy for possible error lies in appellate review.[30] And it is unfortunate that a line of cases ignoring the foreign decree originated in what has since proven a mistaken apprehension of the limits to discretionary power under the Federal Constitution.

The resultant confusion of decisions has led the American Bar Association to introduce into Congress a bill which would in effect definitely extend the application of the "full faith and credit" clause to all equitable decrees.[31] Made quickly and simply operative by means of a registry system similar to that

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[28] *Cf.* Note (1924) 32 A. L. R. 6, 66.

[29] Comment (1930) 39 YALE L. J. 388; Comment (1930) 18 CALIF. L. REV. 159; Note (1924) 32 A. L. R. 6. And see Comment (1928) 37 YALE L. J. 983.

[30] See Fisher v. Pacific Mutual Life Ins. Co., *supra* note 9, at 35, 72 So. at 848.

[31] The bill, drawn up by the Committee on Jurisprudence and Law Reform of the American Bar Association, provides in part: "That whenever any judgment, decree or order shall be rendered by any court of record of the United States or of any state or territory thereof, having jurisdiction of the subject matter and of the parties, requiring that money be paid, or that any act shall or shall not be done, or establishing a status, or investing any person with authority over property, such judgment, decree or order may be registered in any other of said courts, having jurisdiction to render similar judgments, decrees or orders, and when so registered shall have such faith and credit given to it as it has by law or usage in the court wherein it was rendered, and for the purpose of enforcement or utilization it shall have the same effect and like proceedings may be taken thereon as if the judgment, decree or order had been originally rendered by the court in which registration is had." See (1927) 52 A. B. A. Rep. 292 *et seq.*

The full power of Congress to make necessary provisions for the enforcement of the "full faith and credit" clause is expressly granted in the Article itself. *Supra* note 6.

now used in Australia,[32] the proposed act would force a court summarily to dismiss a suit brought by a plaintiff whom the court of any other state had enjoined from bringing that suit. An objection raised in the *Bossung* case to obligatory recognition of the foreign injunction under the "full faith and credit" clause is that the possibility of a foreign court enjoining a man from bringing suit in his own state would give the foreign court "substantial control over our litigation."[33] But the fact that in none of the reported cases was the plaintiff a citizen of the state in which he was attempting to sue, coupled with a reasonable assumption of judicial discretion[34] in the issuance of such injunctions, makes the possibility a remote one. And even the slight danger of abuse of the power seems well overbalanced by the advantages to be gained from a simple and uniform rule which would protect a deserving defendant from the annoyance and expense of vexatious foreign suits[35] instead of leaving him at the mercy of an unscrupulous plaintiff and a foreign court bothered about its privilege to decline jurisdiction.[36]

Until exterritorial recognition of injunctions against suit is forced upon the courts by legislative enactment or a specific judicial ruling of the Federal Supreme Court, the wisest policy seems to lie in voluntary recognition of the decree as controlling. Uncertainty as to the power to refuse jurisdiction has been substantially removed.[37] Once the court which issues the injunction has passed judgment on the facts as to the desirability of allowing suit in another state, a review of those same facts

[32] The Australian act providing for interstate enforcement of judgments declares that "judgments" are to include "any judgment, decree, rule, or order given or made by a Court in any suit whereby any sum of money is made payable or any person is required to do or not to do any act or thing other than the payment of money." AUSTRALIAN COMMONWEALTH ACTS, SERVICE AND EXECUTION OF PROCESS ACT (1901-1924) § 3 (h). To secure exterritorial efficacy without the burdensome and expensive suit on a judgment, it is provided that a certificate thereof, registered in the corresponding court of any other state, shall be for all purposes the same as a local judgment. Since Australia consists of a federal commonwealth of states similar to ours, and the registry method has there been in operation for twenty-nine years, the example seems particularly valuable. See Cook, *The Powers of Congress Under the Full Faith and Credit Clause* (1919) 28 YALE L. J. 421, 426 *et seq.*, and appendices.

[33] State ex rel. Bossung v. District Court, *supra* note 3, at 498, 168 N. W. at 591.

[34] See *supra* note 2. See also Payne v. Knapp, 195 N. W. 1, 2 (Iowa 1923).

[35] *Cf.* (1919) 28 YALE L. J. 503, 504.

[36] The questionable practice of searching for a foreign court noted for its liberal awards has received judicial comment. See Lefebvre-Armistead Co. v. So. Pacific Co., 142 Va. 800, 805, 128 S. E. 244, 245 (1925); Weinard v. Chicago, M. & St. P. Ry., 298 Fed. 977, 981 *et seq.* (D. Minn. 1924).

[37] Reference is to the decision in the Douglas case, *supra* note 17.

by a court of the other state seems unnecessarily repetitious, and subject to all the criticism which has been levelled at the practice of importing litigation.[38] And even if the second court prefers to pass its own judgment on the advisability of allowing the suit in question, it would seem that the mere granting of an injunction by another court should in itself be a strongly persuasive fact toward a refusal to take jurisdiction.[39]

AGREEMENTS NOT TO DEFEND

It seems generally to be assumed that agreements to waive all defenses to any action which might be brought against a party are against public policy and for that reason will not be enforced by the courts. A dictum to this effect uttered by the United States Supreme Court in 1891[1] has been reiterated in the recent case of *Nye v. Chase Nat. Bank*.[2] But where particular defenses alone are waived, there is a contrariety of result, said to depend upon whether the agreement to waive the particular defense is or is not against "public policy." What constitute the criteria of "public policy" can only be determined by a study of the many decisions dealing with such provisions and stipulations.[3]

A distinction should be observed at the outset between the ordinary agreement to confess judgment on a liquidated debt, and an agreement not to defend on any grounds at any time. Typical of the former is a provision in a mortgage or in an indenture agreement made in connection with a bond issue whereby the debtor agrees to consent to the entry of judgment for principal, premium and interest upon default.[4] Judgment notes war-

[38] See Comment (1930) 39 YALE L. J. 388, 397 *et seq.* and notes.

[39] The decision in the Fisher case, *supra* note 9, was based upon somewhat similar reasoning.

[1] Pope Mfg. Co. v. Gormully, 144 U. S. 224, 234 12 Sup. Ct. 632, 636 (1891): "If one should agree for a valuable consideration that he would set up no defense to any action which another might bring against him and such person might enter up judgment against him in any such action without notice, we think no court would hesitate to pronounce such an agreement invalid."

[2] 34 F. (2d) 435 (C. C. A. 8th, 1929). In this case the guarantors attempted to escape from their responsibility on the ground that, the provision waiving all defenses being invalid, the whole guaranty contract was thereby invalidated. The court held that the provision, while in itself void, had no such effect on the rest of the agreement.

[3] For an encyclopedic treatment of this general subject see PAGE, CONTRACTS (2d ed. 1920) c. 23.

[4] The following is a typical agreement: "The company covenants that after the happening of any event of default and at and immediately upon the commencement of any action, suit or other legal proceeding by the trustee to obtain judgment for the principal of, or premium or interest on, the debentures . . . it will waive the issuance and service of process and

ranting an attorney to confess judgment on a certain date have also long been recognized as valid at common law and are usually provided for by statute.[5] They are made as a matter of convenience to avoid a court trial which is unnecessary where there is a definite sum due at a certain time. Nothing is said in such agreements, however, about waiving defenses. Judgment alone is confessed and the debtor is not precluded from moving to vacate or open the judgment rendered against him when he can show the court that he has a valid defense.[6] If an agreement to waive all defenses were to be held enforceable, the result would in effect be that judgment would not only be confessed but the defendant would not thereafter be able to dispute its finality. And in the situation where a waiver of certain defenses only is held enforceable the effect is not that judgment is confessed, but that the defendant finds his hands tied at the trial as to the issues specified in the agreement.

Cases involving reliance by third parties on these express waivers of all or certain defenses must also be distinguished. Thus a mortgagor may expressly agree to waive all defenses in order to facilitate the negotiation of the mortgage,[7] or a debtor may agree to waive all defenses as against an assignee of the chose in action.[8] In such cases the doctrine of estoppel prevents

enter its voluntary appearance in such action, suit or proceeding and consent to the entry of a judgment for such principal, premium and interest . . . and for such other relief as the trustee may be entitled to hereunder." This provision is contained in an Indenture, dated April 15, 1925, between Dodge Bros. and the Central Union Trust Co., trustee, in connection with an issue of debentures. Similar agreements contained in a mortgage empowering the mortgagee on any default in payment of principal or interest to sell the mortgaged premises and apply the proceeds to the debt are valid and enforceable. Wood v. Electric Light Co., 36 Fed. 538 (C. C. S. D. N. Y. 1888); Curran v. Houston, 201 Ill. 442, 66 N. E. 228 (1903); Hawkinson v. Banaghan, 203 Mass. 591, 89 N. E. 1054 (1909); Smith v. Lamb, 59 Misc. 568, 111 N. Y. Supp. 455 (Sup. Ct. 1908).

[5] 3 FREEMAN, JUDGMENTS (5th ed. 1925) §§ 1302, 1303.

[6] Cozart v. Haines, 68 Colo. 261, 188 Pac. 726 (1920); Fiedler v. Bishop, 198 Ill. App. 558 (1916); Lyon v. Welsh, 20 Iowa 578 (1866); Winternitz v. Schmidt, 161 Wis. 421, 154 N. W. 626 (1915).

[7] Smyth v. Munroe, 84 N. Y. 354 (1881) (mortgagor prevented from setting up defense of usury as against assignee of mortgagee); Hutchinson v. Gill, 91 Pa. 253 (1879) (mortgagor prevented from setting up no consideration and fraud as against assignee, the mortgagee having absconded). But *cf.* Wilcox v. Howell, 44 N. Y. 398 (1871) (no estoppel if assignee did not rely on the agreement).

[8] Anglo-California Trust Co. v. Hall, 61 Utah 223, 211 Pac. 991 (1922). But *cf.* San Francisco Corp. v. Phoenix Motor Co., 25 Ariz. 531, 220 Pac. 229 (1923) (statute specifically provided assignments of choses in action should be without prejudice to any set-off or defense; held that mortgagor could defend on ground of fraud). The doctrine of estoppel is particularly applicable in the law of bills and notes. Railroad & Banking Co. v. Stanbrough, 1 La. Ann. 261 (1846); Le Roy v. Meadows, 88 Okla. 45, 200 Pac. 858 (1921); *cf.* Enslen v. Bank, 255 Fed. 527 (C. C. A. 5th, 1919) (estoppel

the defenses waived from being interposed as against third parties. As between parties to the contract, however, the question is not one of estoppel but rather of the extent to which a party may go in depriving himself in advance of well-recognized rights and privileges. And so an agreement may operate to deprive a party of all defenses against a third person and at the same time have no legal effect with respect to the original parties to the contract.

In the latter situation specific agreements to waive the defense of fraud [9] or of usury,[10] not to defend divorce proceedings,[11] or not to oppose the discharge of a debtor in bankruptcy,[12] are universally regarded as so opposed to public policy as to be illegal and void. Similarly the courts will not give effect to a provision in a license agreement wherein the licensee promises never to contest the validity of the patent; [13] to agreements waiv-

after renewal of note); Bank v. Larson, 47 S. D. 374, 199 N. W. 46 (1924) (maker estopped as against one purchasing directly from him); see JOYCE, DEFENSES TO COMMERCIAL PAPER (1st ed. 1907) §§ 646-661.

[9] The following agreement is illustrative: "It is expressly understood and agreed between the parties hereto that the said party of the first part has not, in any manner or form, stated, made or represented to the said party of the second part . . . any statements or representations, verbally or in writing, in any respect to the said business." It was held this did not exclude the defense of fraud. Bridger v. Goldsmith, 143 N. Y. 424, 38 N. E. 458 (1894); see Fay & Egan v. Lumber Co., 178 Ala. 166, 168, 59 So. 470, 471 (1912); *cf.* Malas v. Lounsbury, 193 Wis. 531, 214 N. W. 332 (1927). Agreements to waive all defenses do not preclude the defense of fraud. Welch v. Union Cent. Life Ins. Co., 108 Iowa 224, 78 N. W. 853 (1899); Ranchmen's Trust Co. v. Gill, 113 Kan. 261, 214 Pac. 413 (1923) (agreement not to defend was itself obtained by fraud); Reagan v. Union Mut. Life Ins. Co., 189 Mass. 555, 76 N. E. 217 (1905).

Where representations in a contract act as an inducement to a party to enter into it, a clause to the effect that no reliance is to be placed on such representations is inoperative. United States v. Atlantic Dredging Co., 253 U. S. 1, 40 Sup. Ct. 423 (1920); Jackson v. State, 210 App. Div. 115, 205 N. Y. Supp. 658 (4th Dep't 1924); Dieterich v. Rice, 115 Wash. 365, 197 Pac. 1 (1921); Note (1925) 3 N. Y. L. REV. 219; (1925) 25 COL. L. REV. 231.

[10] Union Nat. Bank v. Fraser, 63 Miss. 231 (1885); Mabee v. Crozier, 22 Hun. 264 (N. Y. 1880); Bosler v. Rheem, 72 Pa. 54 (1872); Sturgis Nat. Bank v. Smith, 9 Tex. Civ. App. 540, 30 S. W. 678 (1895); Herrick v. Dean, 54 Vt. 568 (1882); *cf.* Smyth v. Munroe, *supra* note 7.

[11] Loveren v. Loveren, 106 Cal. 509, 39 Pac. 801 (1895); Smutzer v. Stimson, 9 Colo. App. 326, 48 Pac. 314 (1897); Edleson v. Edleson, 179 Ky. 300, 200 S. W. 625 (1918); Huber v. Culp, 46 Okla. 570, 149 Pac. 216 (1915).

[12] Paton v. Stewart, 78 Ill. 481 (1875); Blasdel v. Fowle, 120 Mass. 447 (1876); Sharp v. Teese, 9 N. J. L. 352 (1828); Bell v. Leggett, 7 N. Y. 176 (1852). Such agreements are now specifically prohibited by the Bankruptcy Act. U. S. COMP. STAT. ANN. (1916) § 9613; Marble v. Grant, 73 Me. 423 (1882); Fulton v. Day, 63 Wis. 112, 23 N. W. 99 (1885).

[13] Pope Mfg. Co. v. Gormully, *supra* note 1; United States v. Standard Oil (Indiana), 33 F. (2d) 617 (N. D. Ill. 1929); (1929) 39 YALE L. J.

ing statutory exemptions of property from execution;[14] to agreements waiving provisions in the bankruptcy laws,[15] emergency rent laws,[16] and eight-hour day statutes;[17] or to agreements exempting landlords from responsibility for damages resulting from illegal distraints.[18]

The antagonistic attitude of the courts to such agreements is to a great extent the result of historical prejudice. Judicial views on public policy are largely determined by former decisions, and the conservative nature of most courts prevents sudden changes in traditional attitudes unless the public demand is so insistent as to compel recognition of agreements once regarded as illegal. Primarily the public is interested in having the court settle disputes in a manner satisfactory to litigants. For the courts to allow the perpetration of fraud, simply because one party has agreed not to interpose it as a defense, would be to condone a practice always regarded as socially undesirable.[19] On the other hand it is conceivable that the traditional attitude

290; *cf.* Buffalo Specialty Co. v. Gougar, 26 Colo. App. 523, 144 Pac. 325 (1914). Where the agreement exists only for the life of the license it is enforceable. Eskimo Pie Corp. v. National Ice Cream Co., 20 F. (2d) 1003 (W. D. Ky. 1927), *aff'd*, 26 F. (2d) 901 (C. C. A. 6th, 1928).

[14] Industrial Loan & Investment Co. v. Superior Court, 189 Cal. 546, 209 Pac. 360 (1922); Weaver v. Lynch, 79 Colo. 537, 246 Pac. 789 (1926); Harper v. Leal, 10 How. Pr. 276 (N. Y. 1854); Dean v. McMullen, 109 Ohio St. 309, 142 N. E. 683 (1923). But a mortgage on exempt property acts as a waiver of the exemption privilege. Woods v. Davis, 153 Ky. 99, 154 S. W. 905 (1913); Kyle v. Sigur, 121 La. 888, 46 So. 910 (1908); Cammarano v. Langmire, 99 Wash. 360, 169 Pac. 806 (1918).

[15] "The Bankruptcy Act would in the natural course of business be nullified in the vast majority of debts arising out of contracts, if this were permissible." Rugg, C. J., in Federal Nat. Bank v. Koppel, 253 Mass. 157, 159, 148 N. E. 379, 380 (1925).

[16] "The preservation of the home is essential to the public welfare . . . To give tenants the full benefit of these laws, they must be protected against the acts of overreaching landlords, who seek to nullify the statutes by requiring tenants who are forced to make new leases agree to waive their provisions." St. Andrews Parish v. Gallagher, 121 Misc. 167, 170, 200 N. Y. Supp. 590, 593 (App. Div. 2d Dep't 1923).

[17] Short v. Bullion-Beck Co., 20 Utah 20, 57 Pac. 720 (1899).

[18] Security Mortgage Co. v. Thompson, 66 Misc. 151, 121 N. Y. Supp. 326 (Sup. Ct. 1910); Watson v. Boswell, 25 Tex. Civ. App. 379, 61 S. W. 407 (1901). If the distraint is legal, such a clause is operative. Watson v. Mirike, 25 Tex. Civ. App. 527, 61 S. W. 538 (1901).

Such agreements not to seek affirmative relief for damages are more closely analogous to provisions exempting public carriers from responsibility for negligence, which are generally held invalid. Liverpool & Great Western Steam Co. v. Insurance Co., 129 U. S. 397, 9 Sup. Ct. 469 (1888). But responsibility can be limited to a "reasonable extent." Adams Express Co. v. Croninger, 226 U. S. 491, 33 Sup. Ct. 148 (1912).

[19] The maxim "fraud vitiates every contract" is sometimes regarded as applicable to the no-defense provision as well as to the rest of the contract. Welch v. Union Cent. Life Ins. Co., *supra* note 9, at 230, 78 N. W. at 855.

toward marriage may so change that courts will regard agreements not to defend divorce proceedings as valid. At the present day, however, such agreements are unhesitatingly declared illegal.[20]

In determining the policy of a state its courts frequently look to the statutes for guidance. Laws as to usury, bankruptcy, property exemption, landlords and tenants, and hours of employment[21] are interpreted by the courts as declaratory of public policy.[22] But not infrequently dispute arises as to whether the law was intended to prohibit certain practices generally, or to confer a privilege upon the individual which might be waived by him as he saw fit. So while the usury laws are regarded by the courts as an expression of public policy, it is apparent today that high rates of interest are not considered as pernicious as was formerly the case.[23] In view of the fact that there are many ways of avoiding the statute it may be contended that a party should now be held to have the power to agree to pay higher rates and waive the benefit of the statute if he so desires. But the attitude of the courts toward other statutes designed to protect debtors, tenants, employees, and vendees is based on the ground that such persons more often contract on an unequal plane and are coerced into waiving certain defenses which the legislature has considered as socially desirable for them to possess. So when an improvident debtor has agreed to waive all exemptions to his personal property the courts will refuse to give effect to his agreement on the theory that "the object of our statutes is to protect those little communities called 'families' in the possession and enjoyment of those articles of prime necessity without which they cannot exist; and the state has a deep interest in their preservation."[24]

On the other hand courts will permit individuals to waive in advance some privileges even though conferred by statute. There has been considerable dispute as to whether the statute of limi-

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[20] "There is an intimate connection between the sanctity of the marriage relation and the well-being of society." Smutzer v. Stimson, *supra* note 11, at 327, 48 Pac. at 315.

[21] *Supra* notes 10, 14, 15, 17 and 18. A statute declaring that the assignment of a chose in action shall be without prejudice to any set-off or defense has also been regarded as conclusive of public policy. San Francisco Corp. v. Phoenix Motor Co., *supra* note 8.

[22] "A party may, undoubtedly, without trenching upon public policy, waive the defense of usury, or of the statute of frauds, or of the statute of limitations, by omitting to set up the defense when sued . . . but no case has occurred to me in which a party can, in advance, make a valid promise that a statute founded on public policy shall be inoperative." Shapley v. Abbott, 42 N. Y. 443, 452 (1870). See Crowe v. Liquid Carbonic Co., 208 N. Y. 396, 403, 102 N. E. 573, 575 (1913).

[23] See Comment (1930) 39 YALE L. J. 408.

[24] Harper v. Leal, *supra* note 14, at 282.

tations is designed for the benefit of the public or for individual litigants, but the tendency of most courts today is to hold not only that agreements to shorten the period or extend it for a reasonable time are valid,[25] but also that the statute may be waived entirely.[26] The right to a trial by jury and certain statutory rules of evidence, such as the presumption that a party is legally dead after an absence of seven years, may also be waived.[27]

Between these two views is a dividing line constantly changing with the mutations in judicial interpretations of public policy. While the attitude toward the statute of limitations is an indication of greater liberality, adherence to long tradition is evidenced by the persistent refusal of the courts in the absence of special legislation to enforce agreements to arbitrate.[28] The rule that such agreements are invalid, "probably originating in the contests of the different courts in ancient times for extent of jurisdiction,"[29] is so opposed to public policy as to provoke

[25] Page County v. Fidelity & Deposit Co., 205 Iowa 798, 216 N. W. 957 (1927); Eliot Nat. Bank v. Beal, 141 Mass. 566, 6 N. E. 742 (1886); Kulberg v. Supreme Council, 135 Minn. 150, 160 N. W. 685 (1916); *cf.* Columbia Security Co. v. Aetna Accident & Liability Co., 108 Wash. 116, 183 Pac. 137 (1919); Note (1928) 26 MICH. L. REV. 810; (1927) 11 MINN. L. REV. 282.

[26] Parchen v. Chessman, 49 Mont. 326, 146 Pac. 469 (1914); Note ANN. CAS. 1916A 686; Lydon Savings Bank v. International Co., 78 Vt. 169, 62 Atl. 50. (1905); Note (1926) 14 CALIF. L. REV. 126; (1925) 74 U. OF PA. L. REV. 193. *Contra:* First Nat. Bank v. Mock, 70 Colo. 517, 203 Pac. 272 (1921); Johnson v. Merritt, 125 Va. 162, 99 S. E. 785 (1919).

[27] *Waiver of Trial by Jury:* Bank of Columbia v. Okely, 4 Wheat. 235 (U. S. 1819); Boyden v. Lamb, 152 Mass. 416, 25 N. E. 609 (1890); Berkowitz v. Arbib & Houlberg, 230 N. Y. 261, 130 N. E. 288 (1921).

Rules of Evidence: Presumption of death by absence. Steen v. Modern Woodmen, 296 Ill. 104, 129 N. E. 546 (1921). *Contra:* Cobble v. Royal Neighbors, 291 Mo. 125, 236 S. W. 306 (1921). What is to constitute conclusive evidence of debtor's responsibility. U. S. Fidelity Co. v. Baker, 136 Ark. 227, 206 S. W. 314 (1918); U. S. Fidelity Co. v. Connors, 222 Ill. App. 1 (1921). Eyewitnesses not necessary for proof of injury. Becker v. Bus. Men's Ass'n, 265 Fed. 508 (C. C. A. 8th, 1920). See Isaacs, *Contractual Control over Adjective Law* (1922) 29 W. VA. L. Q. 1; Wigmore, *Contracts to Change Rules of Evidence* (1921) 55 AM. LAW REV. 823. As to waiver of the Statute of Frauds, *cf.* Little v. Union Oil Co. of Cal., 73 Cal. App. 612, 238 Pac. 1066 (1925) (such an agreement is not operative unless there is reliance and resulting injury).

[28] Grocery Co. v. Talladega Grocery Co., 217 Ala. 334, 116 So. 356 (1928); Hudson Trading Co. v. Durand, 194 App. Div. 248, 185 N. Y. Supp. 187 (1st Dep't 1920). For general discussion of this subject see Cohen, *The Law of Commercial Arbitration and the New York Statute* (1921) 31 YALE L. J. 147; Sturges, *Commercial Arbitration or Court Application of Common Law Rules of Marketing?* (1924) 34 YALE L. J. 480; Grossman, *Trade Security under Arbitration Laws* (1925) 35 YALE L. J. 308; *Commercial Arbitration in England* (1916) 12 AMER. JUD. SOC. BULL. 7.

[29] Lord Campbell in Scott v. Avery, 5 H. L. Cas. 811, 852 (1856).

insistent demands for special legislation authorizing arbitration provisions.[30] In spite of this, however, the very reason assigned for holding these agreements invalid is that they "oust the courts of their jurisdiction" and are therefore "against public policy." [31] It may be noted that, perhaps unconsciously, this fear of being ousted has been overcome to the extent of permitting parties to waive in advance their right to appeal, thus restricting jurisdiction to the trial court.[32]

While public policy, according to judicial opinion, clearly decrees in certain cases that agreements not to defend are invalid, courts cannot overlook the argument that such terms voluntarily inserted in a contract often constitute an important part of the consideration. This frequently occurs in the case of tenants exempting their landlords from responsibility for losses incurred by fire, water, etc.,[33] in contracts exempting private carriers from responsibility for negligence on their part,[34] or in agreements not to contest wills.[35] How far should the courts go in giving effect to the terms of such an agreement and how far in declaring public policy? The answer to this question depends on the particular problem in controversy, on the traditional views on public policy involved, on the economic advantages and disadvantages which will result from a decision either way, on the extent of equality in bargaining position, and on the amount of the consideration represented by the provision.

Inasmuch as there are agreements to waive certain defenses which are clearly invalid, an agreement to waive all defenses,

[30] Legislation has recently been passed making arbitration agreements enforceable by the courts. 11 U. S. C. § 52 (b) (1926); MASS. CUM. STAT. (1927) c. 251, § 2; N. J. COMP. STAT. (Cum. Supp. 1925) § 9-21; N. Y. ANN. CONS. LAWS (Cum. Supp. 1918-20) c. 72, § 2; ORE. LAWS (Supp. 1928) c. 26; 52 & 53 VICT. c. 49 (1889).

[31] See United States Asphalt Refining Co. v. Trinidad Lake Petroleum Co., 222 Fed. 1006, 1008 (S. D. N. Y. 1915).

[32] Hoste v. Dalton, 137 Mich. 522, 100 N. W. 750 (1904); Riggs v. Insurance Co., 125 N. Y. 7, 25 N. E. 1058 (1890); Amory v. Bacharach Quality Stores, 271 Pa. 364, 117 Atl. 435 (1921). *Contra:* General Motors Acceptance Corp. v. Talbott, 38 Idaho 13, 219 Pac. 1058 (1923). Generally, however, "partial ousters" are invalid. Home Ins. Co. v. Morse, 20 Wall. 445 (U. S. 1874) (agreement not to sue in federal courts); Sudbury v. Ambi etc., 213 App. Div. 98, 210 N. Y. Supp. 164 (1st Dep't 1925) (agreement to sue only in the courts of Germany); 2 PAGE, CONTRACTS (2d ed. 1920) § 720; Note (1925) 25 COL. L. REV. 1063; (1926) 35 YALE L. J. 503.

[33] *Cf.* Pecararo v. Grover, 5 La. App. 676 (1927) (leak in roof); Commercial Union Assurance Co. v. Foley Bros., 141 Minn. 258, 169 N. W. 793 (1918) (loss by water or fire); Lerner v. Heicklen, 89 Pa. Super. Ct. 234 (1926) ("loss of property however occurring").

[34] *Cf.* Santa Fe R. R. v. Grant Bros., 228 U. S. 177, 33 Sup. Ct. 474 (1913).

[35] In re Garcelon's Estate, 104 Cal. 570, 38 Pac. 414 (1894); Sellers v. Perry, 191 Mich. 619, 158 N. W. 144 (1916); *cf.* Conklin v. Conklin, 165 Mich. 571, 131 N. W. 154 (1911) (agreement fraudulent).

being inclusive of particular protected defenses, as a matter of logic would also be invalid. The question frequently arises in insurance policies. Where the insurance company inserts a provision that the policy will be incontestable from date, there is actually an agreement not to defend the policy on any account, and the clause is declared invalid.[36] But policies incontestable after the lapse of a certain time from the date of execution are sustainable.[37] Perhaps the most effective stipulation is an agreement not to set up any defense except fraud. Such a provision has been sustained in Kentucky in the case of *Insurance Co. v. Rider*.[38]

There is no reason, however, for declaring an agreement to waive all defenses invalid until the defendant raises a defense that is protected by the courts.[39] This would give effect to the contract as long as it did not infringe upon the judicial inter-

[36] Welch v. Union Cent. Life Ins. Co.; Reagan v. Union Mut. Life Ins. Co., both *supra* note 9.

[37] Insurance Co. v. Snavely, 206 Fed. 20 (C. C. A. 9th, 1913); Ramsay v. Insurance Co., 297 Ill. 592, 131 N. E. 108 (1921); Chinery v. Insurance Co., 112 Misc. 107, 182 N. Y. Supp. 555 (App. Div. 2d Dep't 1920); *cf.* People v. Alexander, 183 App. Div. 868, 171 N. Y. Supp. 881 (1st Dep't 1918) (clause does not prevent a criminal prosecution for larceny). But *cf.* Fay & Egan v. Independent Lumber Co., 178 Ala. 166, 59 So. 470 (1912) (agreement in a bill of sale not to set up fraud after a "reasonable time" held not to preclude vendee from showing fraud in the inducement). It should be noted that besides operating as a waiver of all defenses after the lapse of a certain time, these incontestable clauses also operate to limit the period within which the insurer can bring an action seeking cancellation of the policy. Such agreements to shorten the statutory period of limitations are generally sustained. See *supra* note 27.

[38] 150 Ky. 505, 150 S. W. 649 (1912).

[39] *Cf.* Anglo-California Trust Co. v. Hall, *supra* note 8. In this case a conditional vendee agreed that in the event his vendor assigned his claim to a third party he would thereafter be precluded from attacking the validity of the sale agreement on any ground. Although a statute specifically provided that all assignments of choses in action should be without prejudice to any set-off or other defense, the court held that by his agreement the vendee was precluded from setting up a breach of warranty. But the court specifically stated that this would not prevent the defenses of "fraud, duress, or something against public policy."

The cases involving all-inclusive no-defense provisions and holding them invalid have involved attempts to set up defenses ordinarily considered protected by public policy; they give no basis for assuming that such general clauses would not preclude defenses which would be precluded by a specific agreement with respect to them. In re Lawrence, 166 Fed. 239 (C. C. A. 2d, 1908) (illegality of consideration); J. B. Colt Co. v. Koehn, 128 Okla. 39, 260 Pac. 1060 (1927); *cf.* Osborne v. McQueen, 67 Wis. 392, 29 N. W. 636 (1886) (a waiver of all defenses held not to prevent counterclaim for breach of warranty; the reason given was that warranty agreement was distinct and separate and the waiver provision was hence not applicable); Reisler v. Dempsey, 173 N. Y. Supp. 212 (Sup. Ct. 1918) (an agreement not to defend an injunction is not void where public policy or the interests of third parties are not involved).

pretation of public policy, thus prohibiting a waivable defense such as the statute of limitations but allowing the defense of fraud.

RETROACTIVE ZONING ORDINANCES

Property restriction by means of zoning being still in its formative stage,[1] its limitations are as yet undefined.[2] The problem is practically confined to use regulation,[3] which may be subdivided into two phases—the prohibition of future non-conforming uses and the discontinuance of existing ones. It is the latter which at present causes the greater difficulty.[4]

Many state enabling acts[5] specifically provide that existing uses shall be exempt from the operation of zoning ordinances, or at least that their elimination shall be effected gradually.[6] Thus, the customary method of eliminating non-conforming existing uses is to forbid any alterations or rebuilding,[7] and once those

[1] See Windsor v. Whitney, 95 Conn. 357, 368, 111 Atl. 354, 357 (1920).

[2] Freund, *Some Problems in the Law of Zoning* (1929) 24 ILL. L. REV. 135; *cf.* State of Washington v. Roberge, 49 Sup. Ct. 50, 51 (U. S. 1929).

[3] Other types of restrictions are generally upheld. Welch v. Swasey, 214 U. S. 91, 29 Sup. Ct. 567 (1909) (height); Wulfsohn v. Burden, 241 N. Y. 288, 150 N. E. 120 (1925) (area); People v. Clark, 216 App. Div. 351, 215 N. Y. Supp. 190 (1st Dep't 1926) (bulk); Bassett, *Constitutionality of Zoning* (1924) 13 NAT. MUN. REV. 492; Young, *City Planning and Restrictions* (1925) 9 MINN. L. REV. 518, 593.

The constitutionality of a comprehensive zoning plan embodying a classification of structures according to use has been upheld by the United States Supreme Court. Village of Euclid v. Ambler Realty Co., 272 U. S. 365, 47 Sup. Ct. 114 (1927). Most of the state courts have taken a similar view on the general principle of building restrictions on the basis of use. Lincoln Trust Co. v. Williams, 229 N. Y. 313, 128 N. E. 209 (1920); In re Opinion of the Justices, 234 Mass. 597, 127 N. E. 525 (1920); State v. Harper, 182 Wis. 148, 196 N. W. 451 (1923); City of Aurora v. Burns, 319 Ill. 84, 149 N. E. 784 (1925). *Contra:* Ignaciunas v. Town of Nutley, 99 N. J. L. 389, 125 Atl. 121 (1924); Goldman v. Crowther, 147 Md. 282, 128 Atl. 50 (1925); Spann v. City of Dallas, 111 Tex. 350, 235 S. W. 513 (1921). But *cf.* City of Wichita Falls v. Continental Oil Co., 117 Tex. 256, 5 S. W. (2d) 561 (1928).

[4] BAKER, LEGAL ASPECTS OF ZONING (1927) 144.

[5] The general rule is that there must be a state enabling act before municipalities therein may adopt zoning ordinances. Dawley v. Collingwood, 218 N. W. 766 (Mich. 1928); see Clements v. McCabe, 210 Mich. 207, 210, 177 N. W. 722, 726 (1920).

[6] ILL. REV. STAT. (Cahill, 1927) c. 24, par. 521; KAN. REV. STAT. ANN. (1923) c. 13, art. 2; MASS. GEN. LAWS (1921) c. 40, § 29; N. H. PUB. LAWS (1926) c. 92, § 3; OHIO GEN. CODE (Page, 1926) § 4366-9; WIS. STAT. (1927) § 62.23.

[7] People v. Leo, 193 App. Div. 910, 185 N. Y. Supp. 948 (1st Dep't 1920) (alterations amounting to over 50% of building's value prohibited); State v. Hillman, 147 Atl. 294 (Conn. 1929) (same facts); Ward's Appeal, 289 Pa. 458, 137 Atl. 630 (1927) (old building ordered razed but new structure for similar use forbidden); City of Earle v. Shackleford, 177 Ark. 291, 6

uses have been discontinued or destroyed, a duty arises to abstain thereafter from non-conformity.[8] The validity of these provisions is generally recognized and the few decisions disapproving of their application can be attributed to the unusual circumstances involved.[9] In some situations zoning ordinances may be so construed as to give them retroactive operation. This question of construction always arises in connection with buildings in the process of erection when the ordinances are passed, and it is usually held that the ordinances are without force or effect as to structures of that class.[10] But when municipalities attempt to revoke building permits issued before the enactment of a zoning ordinance, the courts will sustain the revocation provided there has been no "material" action in reliance on the permit.[11] Generally it is only to this extent that the courts have so far permitted zoning ordinances to operate retroactively.

In 1927 the city of New Orleans passed a zoning ordinance prohibiting the establishment of any business within a certain district, designated as residential, and requiring all businesses in operation at the time of its enactment to liquidate or remove within one year.[12] The owners of two stores, the only property affected by the retroactive clauses of the ordinance, appealed to

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S. W. (2d) 294 (1928) (blacksmith shop not permitted to be converted into a filling station); Matter of De Fine v. Board of Health, 217 App. Div. 753, 216 N. Y. Supp. 821 (1st Dep't 1925) (owner forbidden to change garage into poultry slaughtering establishment).

[8] Wilson v. Edgar, 64 Cal. App. 654, 222 Pac. 623 (1923); Collins v. Moore, 125 Misc. 777, 211 N. Y. Supp. 434 (Sup. Ct. 1925); Van Horn v. City of New Orleans, 161 La. 767, 109 So. 484 (1926); Freund, *op. cit. supra* note 2, at 138.

[9] Bartkus v. Albers, 189 Wis. 539, 208 N. W. 260 (1926) (addition to store permitted, addition being for residential purposes); Liberty Lumber Co. v. City of Tacoma, 142 Wash. 377, 253 Pac. 122 (1927) (erection of two additional structures by existing business held not the "establishment" of a business as forbidden by the ordinance); Appeal of Haller Baking Co., 295 Pa. 257, 145 Atl. 77 (1928) (stable used only occasionally for team of horses held not to be "discontinued" in sense it must thereafter conform to ordinance).

[10] Building Height Cases, 181 Wis. 519, 195 N. W. 544 (1923); Pelham View Apartment v. Switzer, 130 Misc. 545, 224 N. Y. Supp. 56 (Sup. Ct. 1927); Rosenberg v. Village of Whitefish Bay, 225 N. W. 838 (Wis. 1929); City of New Britain v. Kilbourne, 147 Atl. 124 (Conn. 1929); Freeman v. Hague, 147 Atl. 553 (N. J. 1929). *Contra:* Ware v. City of Wichita, 113 Kan. 153, 214 Pac. 99 (1923) (erection of building begun before ordinance was adopted enjoined after it went into effect).

[11] People v. Kleinert, 237 N. Y. 80, 143 N. E. 750 (1924) (construction not started); Brett v. Building Comm'r, 250 Mass. 73, 145 N. E. 269 (1924) (only excavations had been dug); State v. Christopher, 317 Mo. 1179, 298 S. W. 720 (1927) (construction not started). But *cf.* Carlton Court v. Switzer, 221 App. Div. 799, 223 N. Y. Supp. 856 (1st Dep't 1927) (construction had started).

[12] Ordinance No. 9651.

the courts.[13] In both cases, the Supreme Court of Louisiana upheld the ordinance. While no other court has been found which has passed directly upon the question there involved,[14] there are considerable dicta to the effect that retroactive ordinances are invalid,[15] and zoning and city-planning authorities unanimously advise against them.[16] The purpose of zoning, which is said to be the crystallization of present conditions and the constructive control of future development,[17] does not require that existing uses be changed. Hence it has been generally assumed that any attempt to make zoning ordinances retroactive would meet with the opposition of the courts and might result in their declaring the ordinances as a whole unconstitutional.

One aspect of the problem is brought out in the Louisiana court's attempt to justify the retroactive operation of the ordinance on the ground that the use of land for a store in the restricted district was a nuisance. It is a common occurrence, where there are zoning ordinances in effect, for the exclusions to begin with nuisances and near-nuisances, over which municipalities have always had extensive control.[18] The first zoning

[13] State v. MacDonald, 121 So. 613 (La. 1929); State v. Jacoby, 123 So. 314 (La. 1929).

[14] See Tooke, *Judicial Decisions* (1929) 18 NAT. MUN. REV. 492.

[15] See City of Aurora v. Burns, *supra* note 3, at 96, 149 N. E. at 789; Blumenthal v. Cryer, 71 Cal. App. 668, 670, 236 Pac. 216, 217 (1925); Adams v. Kalamazoo Ice Co., 222 N. W. 86, 87 (Mich. 1928); Durkin Lumber Co. v. Fitzsimmons, 147 Atl. 555, 558 (N. J. 1929).

[16] Bassett, *Zoning* (1920) 9 NAT. MUN. REV. 315, 330; Chamberlain and Pierson, *Constitutionality of Zoning* (1924) 10 A. B. A. J. 135; Bettman, *Constitutionality of* Zoning (1924) 37 HARV. L. REV. 834; Young, *op. cit. supra* note 3, at 626; Byrne, *Constitutionality of a General Zoning Ordinance* (1927) 11 MARQUETTE L. REV. 189; BAKER, *op. cit. supra* note 4, at 145.

It was at one time suggested that the exemption of existing uses from the operation of the zoning ordinances would be unlawfully discriminatory. See People v. Kaul, 302 Ill. 317, 323, 134 N. E. 740, 742 (1922). But it is now recognized that such discrimination is not only reasonable but necessary. See City of Aurora v. Burns, *supra* note 3, at 97, 149 N. E. at 789; Lincoln Trust v. Williams, *supra* note 3, at 318, 128 N. E. at 210; State v. Harrison, 164 La. 564, 570 114 So. 159, 161 (1927); Sampere v. City of New Orleans, 166 La. 776, 779, 117 So. 827, 828 (1928); Spencer-Sturla Co. v. Memphis, 155 Tenn. 70, 88, 290 S. W. 608, 614 (1926).

[17] See BAKER, *op. cit. supra* note 4, at 144; Bassett, *op. cit. supra* note 16, at 321.

[18] See Young, *op. cit. supra* note 3, at 595. The question of just what constitutes a nuisance in this connection is beyond the scope of this paper. For further discussion, see Young, *op. cit. supra* note 3, at 612; Bettman, *op. cit. supra* note 16, at 836 *et seq.*

In State v. Jacoby, *supra* note 13, at 317, it is suggested that the removal of the drug store is also justifiable as it constitutes a fire hazard due to "the inflammable tendency of so much of its contents." In the establishment of fire districts—another forerunner of the more recent zoning development—where the construction of wooden buildings is prohibited, the

ordinances held valid amounted in fact to little more than nuisance regulations.[19] The law of nuisances, however, was inadequate to take care of all the exigencies that arose in zoning development and the courts were driven to such an elasticity of definition of the uses that could be declared nuisances that the term lost all meaning as a practical measure of legislative power.[20]

This background of nuisance law in the development of zoning occasionally leads to erroneous results. Property regulation by means of zoning is not restricted to what is disorderly or offensive. The so-called "nuisance concept" of zoning is responsible not only for an unjustified reduction of the scope of zoning but also for unsound distinctions, such as the one which results in excluding factories from residential districts as nuisances

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ordinances generally operate prospectively, but retroactive regulations have occasionally been upheld. Hine v. City of New Haven, 40 Conn. 478 (1873); Houlton v. Titcomb, 130 Ind. 149, 28 N. E. 849 (1906); Greenough v. Allen Theatre and Realty Co., 33 R. I. 120, 80 Atl. 260 (1911); *cf.* City of Marysville v. Standard Oil Co., 27 F. (2d) 478 (C. C. A. 8th, 1928).

[19] Comment (1923) 32 YALE L. J. 833; Byrne, *op. cit. supra* note 16, at 197.

This development began with the courts sanctioning the removal of a business the operation of which was clearly a public nuisance in the community where it was situated. Fertilizing Co. v. Hyde Park, 97 U. S. 659 (1878); Crowley v. Christenson, 137 U. S. 86, 11 Sup. Ct. 13 (1890). The power of municipalities gradually extended from this to prohibiting in residential districts industries and certain other uses of property which, although not nuisances *per se*, were equally objectionable in some locations. Ex parte Quong Wo, 161 Cal. 220, 118 Pac. 714 (1911) (laundry); Reinman v. City of Little Rock, 237 U. S. 171, 35 Sup. Ct. 511 (1914) (livery stable); Hadacheck v. Sebastian, 239 U. S. 394, 36 Sup. Ct. 143 (1917) (brick yard). The last case involved an extreme example of hardship to the individual, causing a loss of $800,000 in the value of the property. The result was justified as an exercise of the police power which the Court characterized as "one of the most essential powers of government and one that is the least limitable." In its opinion the Court did not base its decision squarely on the fact that the forbidden use of the property was a nuisance. As a result some courts have been misled as to what the case actually holds. See City of Marysville v. Standard Oil Co., *supra* note 18, at 484.

The exclusion of some types of businesses, such as funeral establishments, from residential sections is invariably placed on the ground of nuisance, in spite of the fact that there are zoning ordinances prohibiting such business in force. Brown v. City of Los Angeles, 183 Cal. 78, 192 Pac. 716 (1920); Cunningham v. Miller, 178 Wis. 22, 189 N. W. 531 (1922); Spencer-Sturla Co. v. Memphis, *supra* note 16; Ex parte Ruppe, 80 Cal. App. 629, 252 Pac. 746 (1927); City of Tucson v. Arizona Mortuary Co., 272 Pac. 923 (Ariz. 1928).

[20] *Cf.* City of Syracuse v. Snow, 123 Misc. 568, 205 N. Y. Supp. 785 (1st Dep't 1924) (sorority house prohibited as a nuisance); City of New Orleans v. Liberty Dress Shop, 157 La. 26, 101 So. 798 (1924) (ladies' wearing apparel shop enjoined as a nuisance).

while allowing stores and apartment houses to remain as non-nuisances.[21] Furthermore, in attempting to apply to all types of zoning ordinances the summary methods of prevention and suppression which are employed in the case of nuisances, municipalities obviously fail to take into account the fact that zoning not only includes but also supplements nuisance regulation. A restriction imposed to prohibit an offensive use is not a taking of property for which compensation must be made[22] and in the abatement of nuisances retroactive measures are valid.[23] Granting that a zoning ordinance may operate retroactively where there is clearly an element of nuisance, it does not follow that a similar disposition may be made of every type of non-conforming use dealt with in zoning.[24] Use of land for a general store or drug store, as in the Louisiana cases, hardly corresponds with ordinary concepts of nuisance. The enforcement of a retroactive regulation where the uses of land affected can scarcely be called nuisances should not be sustained simply because the regulation is incorporated in a zoning ordinance.[25]

The serious deprivation of valuable interests in existing physical property which is accomplished by the New Orleans ordinance presents a question as to the validity of retroactive zoning regulations. The fact that a restriction results in some financial loss does not thereby exempt the property from its operation.[26] Yet while courts profess to disregard value alone as a standard in determining whether or not a zoning ordinance is reasonable, they generally hold unreasonable what may seem to be a lawful regulation when it causes an unusually large or total deprivation of the beneficial use of property.[27] In an analogous situation in

[21] State v. Houghton, 134 Minn. 226, 158 N. W. 1017 (1916); Welch v. City of Niagara Falls, 210 App. Div. 170, 205 N. Y. Supp. 454 (4th Dep't 1924); Wergin v. Voss, 179 Wis. 603, 192 N. W. 51 (1923). Where this nuisance theory of segregation is followed, the benefits of zoning to industry are said to be dubious. McLaurin, *Where Zoning Fails* (1928) 17 NAT. MUN. REV. 257.

[22] See California Reduction Works v. Reduction Co., 199 U. S. 306, 324, 26 Sup. Ct. 100, 105 (1905).

[23] See Brown v. Grant, 2 S. W. (2d) 285, 287 (Tex. 1928).

[24] "Zoning is not a panacea and cannot be stretched to cover the entire field of private restrictions." Bassett, *op. cit. supra* note 3, at 498; *cf.* Van Hecke, *Zoning Ordinances and Restrictions in Deeds* (1928) 37 YALE L. J. 407, 425.

[25] See Dobbins v. City of Los Angeles, 195 U. S. 223, 236, 25 Sup. Ct. 18, 20 (1904).

[26] See Zahn v. Board of Public Works, 274 U. S. 325, 327, 47 Sup. Ct. 594, 595 (1927); Spector v. Building Inspector, 250 Mass. 63, 145 N. E. 265, 267 (1924); People v. Clark, *supra* note 3, at 360, 215 N. Y. Supp. at 198; Swan, *The Law of Zoning* (1921) 10 NAT. MUN. REV. 519.

[27] Nectow v. City of Cambridge, 277 U. S. 183, 48 Sup. Ct. 447 (1928); Village of Terrace Park v. Errett, 12 F. (2d) 240 (C. C. A. 6th, 1926);

building-line restriction,[28] another court has recently decided that the attempted regulation went too far.[29] In that case, an ordinance established a set-back line the enforcement of which would have reduced the complainants' property to a depth of only two and one-half feet. This was held to be a taking in the constitutional sense, entitling the owner to compensation, and therefore invalid. It is difficult to distinguish the hardship in such an instance from that caused by a retroactive zoning ordinance which deprives an owner of the use to which his property is lawfully devoted when the ordinance becomes effective.

In holding ordinances invalid because of the extent of the diminution in value caused by their application, the courts speak of the operation of the ordinance as impairing the property owner's vested rights [30] or as constituting a taking which would require compensation.[31] The legal theories of vested rights have little significance in this connection,[32] but to decide the question of the validity of a zoning ordinance on the basis of whether there is a "taking" requiring compensation is to confuse the issues involved.[33] Zoning is generally assumed to be an exercise

Sundlun v. Zoning Board of Review, 145 Atl. 451 (R. I. 1929); Heffernan v. Zoning Board of Review, 144 Atl. 674 (R. I. 1929).

[28] In an early case, an ordinance requiring owners of abutting property to conform to established set-back lines was held invalid, the chief issue, however, being over the validity of a frontage consent provision. Eubank v. City of Richmond, 226 U. S. 137, 33 Sup. Ct. 76 (1912). But in later cases, where that issue was not involved, such ordinances have been upheld and compensation has been held unnecessary. In re Philadelphia Parkway, 250 Pa. 257, 95 Atl. 429 (1915); Windsor v. Whitney, *supra* note 1; State v. Houghton, 171 Minn. 231, 213 N. W. 907 (1927); Gorieb v. Fox, 274 U. S. 603, 47 Sup. Ct. 675 (1927); Sundeen v. Rogers, 141 Atl. 142 (N. H. 1928).

[29] In re Sansom Street, 293 Pa. 483, 143 Atl. 134 (1928); (1928) 38 YALE L. J. 678.

[30] See People v. Stanton, 125 Misc. 215, 216, 211 N. Y. Supp. 438 (Sup. Ct. 1925); Pelham View Apartment v. Switzer, *supra* note 10, at 546, 224 N. Y. Supp. at 58; Matter of Bregman, 223 App. Div. 756, 227 N. Y. Supp. 776 (1st Dep't 1928); Brett v. Building Comm., *supra* note 11, at 79, 145 N. E. at 271; Durkin Lumber Co. v. Fitzsimmons, *supra* note 15, at 557.

[31] See Penn Coal Co. v. Mahon, 260 U. S. 393, 413, 43 Sup. Ct. 158, 159 (1922).

[32] Comment (1925) 34 YALE L. J. 303; (1928) 41 HARV. L. REV. 667; *cf.* City of Clinton v. Donnelly, 203 Iowa 576, 578, 213 N. W. 262, 263 (1927).

[33] The problem of when zoning regulation may result in what the courts hold to amount to a taking of private property for which compensation should be made is not confined to retroactive ordinances. It may arise where cities attempt to restrict the future development of certain existing uses with which the land may have become impressed. In re Gilfillan's Permit, 291 Pa. 358, 140 Atl. 136 (1927) (where business had been conducted on present site for seven years, refusal to allow it to rebuild its structures not sustained); Western Theological Seminary v. City of Evanston, 331 Ill. 257, 162 N. E. 863 (1928) (city not allowed to forbid

of the police power,[34] and the only noteworthy effort to accomplish similar results by means of the power of eminent domain has demonstrated that where compensation is required zoning is impractical.[35] By attempting to accomplish through zoning measures results which are upheld only if done under eminent domain,[36] and for which compensation is therefore given, municipalities are overlooking a distinction[37] that has proved itself essential in the development of zoning.

Two general propositions may be advanced, which, although they will not ultimately settle the question, may serve as guides to determining the probable validity or invalidity of zoning ordinances. Such ordinances should not embody restrictions which bear no relation to the real purpose of zoning;[38] and their application should not result in rendering a land owner unable to make

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erection of college dormitory). But *cf.* American Wood Products Co. v. City of Minneapolis, 21 F. (2d) 440 (D. C. 1927), *aff'd*, 35 F. (2d) 657 (C. C. A. 8th, 1929) (long-established business not allowed to expand on its own land).

[34] Freund, *op. cit. supra* note 2, at 139; Anderson, *Zoning in Minnesota—Eminent Domain v. Police Power* (1927) 16 NAT. MUN. REV. 624; HUBBARD, OUR CITIES TODAY AND TOMORROW (1929) 23, 162.

[35] In Minnesota zoning was at first based on the power of eminent domain. Minn. Laws 1915, c. 128; State v. Houghton, 144 Minn. 1, 176 N. W. 159 (1920). This did not prove successful and in 1921 another enabling act basing zoning on the police power was passed and later upheld by the courts. Minn. Laws 1921, c. 217; State v. Houghton, 164 Minn. 146, 204 N. W. 569 (1924); Anderson, *op. cit. supra* note 34.

[36] See American Wood Products Co. v. City of Minneapolis, *supra* note 33, at 444.

[37] For discussions of the distinction between the police power and the power of eminent domain, see FREUND, POLICE POWER (1904) § 511; Comment (1920) 30 YALE L. J. 171; Comment (1923) 32 YALE L. J. 833.

[38] See *supra* note 17, and text. An example of restrictions having no relation to this purpose is the practice, commonly called "dumping," of prohibiting within the limits of a municipality the uses which the community needs but which it would prefer to have inflicted on some other community, *e. g.*, certain types of eleemosynary institutions. The courts have held invalid practically every effort of this sort that has come before them. Mineola Home for Cardiac Children v. Village of Irvington, N. Y. Sup. Ct. Westchester County (1925) (not reported); City of Wilmington v. Turk, 14 Del. Ch. 392, 129 Atl. 512 (1925) (maternity hospital); Shackleford v. Board of Adjustment, Colo. Dist. Ct. (1925) (not reported) (extension of a tuberculosis hospital); Jardine v. City of Pasadena, 199 Cal. 64, 248 Pac. 225 (1925) (hospital for infectious diseases); University Heights v. Cleveland Jewish Orphans' Home, 20 F. (2d) 743 (C. C. A. 6th, 1927), *aff'd* without opinion, 275 U. S. 569, 48 Sup. Ct. 141 (1927); Law v. City of Spartanburg, 148 S. C. 249, 146 S. E. 12 (1928) (tuberculosis hospital); State of Washington v. Roberge, *supra* note 2 (veterans' hospital); Note (1927) 21 ILL. L. REV. 284. But *cf.* Jewish Consumptives Relief Society v. Town of Woodbury, N. Y. Sup. Ct. Orange County (1929) (not reported).

any practical use of his property.[39] A failure by a municipality to take these considerations into account in framing and enforcing an ordinance might well justify a court in holding such an ordinance invalid as being "an interference with private rights upon the claim of a promotion of what is vaguely termed the general welfare." [40]

[39] Nectow v. City of Cambridge, *supra* note 27. See Chamberlain, *Zoning Progress* (1929) 15 A. B. A. J. 535, 537.

[40] See City of Providence v. Stephens, 47 R. I. 387, 391, 133 Atl. 614, 616 (1926).