Comments

NEGOTIABILITY OF CORPORATE BONDS—RECENT NEW YORK LEGISLATION

LEGISLATION designed to assure the negotiability of corporate bonds has recently been adopted in New York.[1] The new law takes the form of an amendment to the Hofstadter Act[2] passed in 1926 to render interim certificates negotiable.[3] This Act as now amended defines a corporate bond in Section 260 (3) as:

> ". . . any bond, debenture, note or other written corporate obligation, forming part of a series of similar bonds, debentures, notes or other written corporate obligations, issued under or the payment of which is secured by a mortgage or deed of trust . . . or issued under or secured by a collateral trust agreement or any other indenture identified or described in such obligation; and any certificate of a trustee, whether or not so issued or secured, forming part of a series of similar trustee's certificates, which evidences the right to a share or part of any specified corporate obligation or obligations and the security relating thereto, if there be any such security; and any interest coupon appertaining to any of the foregoing described instruments."

[1] N. Y. PERSONAL PROPERTY LAW (1930) art. 8, §§ 260-262.

[2] N. Y. PERSONAL PROPERTY LAW (1926) art. 8, §§ 260-262. This Act, as it was before the present amendment, may be found in N. Y. CONS. LAWS (Cahill, 1928 Supp.) c. 42, §§ 260-262.

[3] The Court of Appeals in Manhattan Co. v. Morgan, 242 N. Y. 38, 150 N. E. 594 (1926), held interim certificates entitling the bearer to certain bonds when, as and if received by the signer to be non-negotiable because of the requirements of § 1 of the N. I. L. that "an instrument to be negotiable . . . must contain an unconditional promise . . . to pay a sum certain in money." Security receipts being generally dealt in as if negotiable, the ensuing agitation among lawyers and investment bankers resulted in the Hofstadter Act, intended to make such receipts negotiable. The Manhattan case was clearly in accord with prior decisions. Babcock v. National Surety Co., 106 Misc. 149, 175 N. Y. Supp. 432 (Sup. Ct., 1919), *aff'd*, 190 App. Div. 941, 179 N. Y. Supp. 909 (1st Dep't 1920) (purchaser in good faith from thief obtained no title against former owner); Orth v. Bell, 215 App. Div. 738, 212 N. Y. Supp. 726 (3d Dep't 1925) (receipts non-negotiable under N. I. L.). See Economic Developing Co. v. General Chinaware Corp., 200 N. Y. Supp. 228, 229 (Sup. Ct. 1923) (estoppel necessary to sustain negotiability). *Cf.* Security National Bank v. Peoples Bank, 287 Mo. 464, 230 S. W. 87 (1921) (receipts for Liberty Bonds held negotiable by Act of Congress); Bowie v. National City Bank, 122 Wash. 269, 210 Pac. 498 (1922) (receipt for certificate of deposit not negotiable); Hearne v. Gillette, 151 La. 79, 91 So. 634 (1922) (security receipt not negotiable); Radke v. Liberty Insurance Co., 37 Idaho 436,

Corporate bonds,[4] as thus defined, are placed on the same footing as interim receipts.

The amendment in question was quite evidently prompted by the latest pronouncement of the Court of Appeals in *Enoch v. Brandon*[5] that the negotiability of corporate bonds is to be

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216 Pac. 1040 (1923) (receipts for bonds not negotiable). The Manhattan case was widely noted. Note (1926) 12 CORN. L. Q. 97; (1926) 35 YALE L. J. 877; Note (1926) 39 HARV. L. REV. 875; Note (1926) 74 U. OF PA. L. REV. 727. For a later case reaching a contrary result, see Hopple v. Cleveland Discount Co., 25 Ohio App. 138, 157 N. E. 414 (1927).

[4] Unless otherwise noted, the term "corporate bond" is used throughout this note in the broad sense set forth in the amendment.

It will be noted that practically every requirement of § 1 of the N. I. L. is abrogated in respect to the defined instruments. The definition eliminates all matters of certainty of amount or time of payment, disregards the possible presence of express conditions to a right to payment, and is so phrased as to embrace promises to do other acts than to pay money. Compare the bonds held non-negotiable in the following early cases: Knight v. Wilmington & Manchester R. R., 1 Jones 357 (N. C. 1854) (additional promise not of money); McClelland v. Norfolk Southern R. R., 110 N. Y. 469, 18 N. E. 237 (1888) (provision for extending time of payment on contingency not within control of holders); Ledwich v. McKim, 53 N. Y. 307 (1873) (stolen, incomplete bond); Parsons v. Jackson, 99 U. S. 434, 439 (1878) (uncertainty of amount); Chouteau v. Allen, 70 Mo. 290 (1879) (uncertainty of time of payment); Jackson v. Vicksburg, S. & T. R. R., Fed. Cas. No. 7150, at 257 (C. C. La. 1876) (uncertainty of place of payment); Augusta Bank v. Augusta, 49 Me. 507, 517 (1860) (no words of negotiability). That the N. I. L. should never have been thought to apply to bonds, see Note (1925) 25 COL. L. REV. 71; Note (1926) 39 HARV. L. REV. 875; BRANNAN, NEGOTIABLE INSTRUMENTS LAW (4th ed., 1926) vi., 7-8; 2 MACHEN, CORPORATIONS (1908) § 1740A.

As defined in the amendment any corporate obligation becomes "negotiable" if issued in a series under some sort of security device. Unsecured bonds, however, apparently not covered by this law, are sometimes issued. Moreover, it seems strange that perpetual bonds, to become due only on exercise of the obligor's option as set forth in an accompanying indenture charging the obligor's income with merely the payment of interest, should be "negotiable" while an unsecured bond payable to *J. S.* is non-negotiable for lack of the word "order." As for a bearer bond, registered by exercise of the option therein, only the terms of § 261 (1), *infra* note 36, prevent it from being made "negotiable" by this statute. In such a case, the bond, since it provides for payment "to the bearer, or, if registered, to the registered holder," no longer "by its terms" entitles "the bearer to the benefits thereof" and so is not "negotiable." The case excluded by the requirement of an issue in series is that of one large obligation delivered to a trustee. There is no intention or usage of negotiability in this situation, and the restriction seems reasonable.

[5] 249 N. Y. 263, 164 N. E. 45 (1928), *rev'g* 224 App. Div. 692, 228 N. Y. Supp. 789 (4th Dep't 1928), and *aff'g* 128 Misc. 695, 220 N. Y. Supp. 294 (Sup. Ct. 1927). In this case certain coupon bonds contained a promise to pay the bearer in 1941. The bonds bore provisions for redemption and acceleration and referred to the trust mortgage "for a description of the property mortgaged and pledged, the nature and extent of the security, the rights of the holders of the bonds with respect thereto, the manner in

determined solely by considering whether the formal requisites of Section 1 of the Negotiable Instruments Law [6] are satisfied and that the attempt to insure "negotiability by contract" was unavailing.[7] The holding that the negotiability of corporate bonds depends upon compliance with the first section of the Negotiable Instruments Law finds ample support in prior New York [8] and other state [9] court decisions. But the dictum nega-

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which notice may be given to such holders and the terms and conditions under which said bonds are issued and secured." There was a further provision that they were "to be treated as negotiable" and all persons were "invited by the company to act accordingly." Certain of the bonds were stolen from the plaintiff and negotiated before maturity to the defendant, a *bona fide* puchaser for value. In a suit for the bonds or their value, judgment for the defendant in the trial court was affirmed. The court held the bonds to be negotiable under the N. I. L. § 1 to which any instrument must conform to be negotiable; the reference on the bond to the trust mortgage was regarded as relating only to the security and not as rendering the promise to pay conditional.

[6] Except where noted the original numbering of the Uniform Law is followed.

[7] "True, to become negotiable, an instrument need not follow any precise language. . . . But it must conform to the definition specified in Section 20 [N. I. L. § 1]. In the face of a command so explicit we must adhere to the design of the Legislature." Andrews, J., 249 N. Y. 263, 266, 164 N. E. 45, 46.

[8] Hibbs v. Brown, 190 N. Y. 167, 82 N. E. 1108 (1907) (bond payable only out of joint assets of a joint stock association regarded as a promise on general credit of quasi-corporate entity and thus negotiable under N. I. L.); Higgins v. Hocking Valley Ry., 188 App. Div. 684, 177 N. Y. Supp. 444 (1st Dep't 1919) (reference to mortgage for statement of security and acceleration provisions not a qualification of the promise to pay, bond negotiable under N. I. L.); *cf.* Morris v. Muir, 111 Misc. 739, 181 N. Y. Supp. 913 (Mun. Ct. 1920), *aff'd*, 191 App. Div. 947, 181 N. Y. Supp. 945 (1st Dep't 1920) (*bona fides* of bond purchaser determined by N. I. L.); Interboro Brewing Co. v. Doyle, 165 App. Div. 646, 151 N. Y. Supp. 325 (3d Dep't 1915) (pledgees of bonds held *bona fide* holders under N. I. L.). Compare also cases, *supra* note 3, applying the N. I. L. to interim certificates. It must be remarked that only such cases as hold the bonds non-negotiable can be strictly regarded as holdings on the point inasmuch as the common law would regard the bonds in question as negotiable without reference to the N. I. L. BRANNAN, *op. cit. supra* note 4, at 7.

[9] The following decisions apply the N. I. L. to questions involving the negotiability of bonds. Pratt v. Higginson, 230 Mass. 256, 119 N. E. 661 (1918) (broker selling stolen bonds in good faith not guilty of conversion since bonds were held negotiable); Dengler v. Paul, 83 Pa. Sup. Ct. 37 (1924) (same); Crum v. Hanna, 140 Va. 366, 125 S. E. 219 (1924) (maker's defense of fraud unavailable against holder in due course); Nickey v. Lonsdale Mfg. Co., 149 Tenn. 1, 257 S. W. 403 (1924) (holder in due course permitted to enforce payment of bonds held negotiable, though pledged to him in breach of faith); King Cattle Co. v. Joseph, 158 Minn. 481, 198 N. W. 798 (1924) (particular reference in bonds to terms of trust mortgage held to render them non-negotiable); Grosfield v. First National Bank, 73 Mont. 219, 236 Pac. 250 (1925) (Liberty Bonds held negotiable); Manker v. American Savings Bank & Trust Co., 131 Wash.

tiving the possibility of insuring "negotiability by contract"—a possibility suggested by Judge Cardozo in *Manhattan Co. v. Morgan*[10] decided two years previously—revealed more clearly than ever before that the ultimate decision as to the negotiability of corporate bonds was to be determined by a judicial interpretation of the formal nature of various clauses contained in the instrument rather than by the clear intent of the draftsman.[11] Commercial necessity demands a high degree of certainty as to whether specific bonds are negotiable.[12] The present legislation is a hurried attempt to attain this certainty by eliminating the formal requirements of the Negotiable Instruments Law. Although the amendment probably obviates most questions of form,[13] its brevity and loose wording leave the legal effect of the "negotiability" conferred a matter of speculation in many respects.

The attributes of the "negotiability" with which corporate bonds are now endowed in New York are apparently to be found set forth entirely within the terms of the amendment in

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430, 230 Pac. 406 (1924) (municipal bonds payable only out of future assessments held non-negotiable and *bona fide* purchaser refused protection against former owner); Jones v. American Savings Bank & Trust Co., 139 Wash. 598, 247 Pac. 1017 (1926) (same); Montvale v. Peoples Bank, 74 N. J. L. 464, 67 Atl. 67 (1907) (protection accorded holder in due course of stolen municipal bonds); Adrian v. Whitney National Bank, 180 Mich. 171, 146 N. W. 654 (1914) (same); Linbarger v. Board of Education, 83 N. J. L. 446, 85 Atl. 235 (1912) (lack of delivery no defense when negotiable bonds came to hands of holder in due course); Stevens v. Berkshire Street Ry., 247 Mass. 399, 142 N. E. 59 (1924) (bonds negotiable, demand unnecessary before suit against primary party); Irwin v. Bedford County, 151 Tenn. 402, 270 S. W. 81 (1925) (county refused defense of irregularity of issue against *bona fide* bondholders); Brokaw v. Kunze, 127 Wash. 593, 221 Pac. 590 (1923) (pledgee of bonds held holder in due course and entitled against true owner); Parks v. Hughes, 157 La. 914, 103 So. 261 (1925) (N. I. L. requirement of good faith applied to bond purchase); Brown v. Southwestern Farm Mortgage Co., 112 Kan. 192, 210 Pac. 658 (1922); Bank of California v. National City Co., 138 Wash. 517, 244 Pac. 690, on rehearing 141 Wash. 243, 251 Pac. 561 (1926) (bond conforming with N. I. L. requirements held negotiable for all purposes).

[10] *Supra* note 3. See also *infra* note 22.

[11] Acceleration clauses, redemption and release provisions, tax allowances, reference to a collateral deed of trust, powers of registration, are a few typical examples of provisions contained in corporate indentures which might render such instruments non-negotiable under § 1 of the N. I. L. In King Cattle Co. v. Joseph, *supra* note 9, a provision for alteration by the trustee of the bondholder's rights led the court to declare the bonds non-negotiable under the above section.

[12] Bonds have long been dealt in as negotiable. The practice was well established in 1864. Murray v. Lardner, 2 Wall. 110 (U. S. 1864); Aigler, *Recognition of New Types of Negotiable Instruments* (1924) 24 COL. L. REV. 563, 582; 2 MACHEN, *op. cit. supra* note 4, at §§ 1730, 1737, 1740A.

[13] *Supra* note 4.

question. Yet the statement that the amendment renders corporate bonds "negotiable" [14] indicates little as to its operative effect. The adjective may mean only that they are transferable so as to enable the transferee to sue thereon in his own name, as under the early statutes making bills of lading "negotiable." [15] As used in the later Bills of Lading, Warehouse Receipts and Stock Transfer Acts, it may mean that indorsement and delivery to a *bona fide* purchaser for value will cut off former owners' equities based on fraud, duress, mistake and the like, and give the purchaser the vendor's warranty of genuineness, yet neither make the indorser contingently liable for performance by the signer nor affect in any way the signer's liability thereon.[16] If the term "negotiable" is used as in the Negotiable Instruments Law, it may mean that an indorser becomes liable for payment on default of the maker, and that where such an instrument is transferred to a holder in due course, so-called "personal" defenses of the maker are cut off.[17]

The inclusion of bonds in the category of security receipts, special instruments with a unique history, form and function,

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[14] The amended Act nowhere explicitly provides that bonds are to be "negotiable," but it does declare that the law "shall not be construed to limit or impair the negotiability . . . of any instrument whether or not defined herein." § 262, *infra* note 21. Furthermore, § 261, governing the mode and effect of transfer, is entitled "Negotiation," and it is provided, § 260, that the "character" of any of the defined instruments is not to be affected "by the inclusion therein of other provisions not limiting . . . the negotiable quality thereof as in this article provided." That "negotiability" is the objective may be assumed.

[15] Bills and notes "may be transferred by indorsement and delivery . . . and the capability of being thus transferred, so as to give the indorsee a right to sue on the contract in his own name, is what constitutes negotiability." Then after speaking of the liability of an indorser and the cutting off of the maker's defenses by negotiation, "a bona fide purchaser for value paid acquires title to it even as against the true owner. . . . But none of these consequences are necessary attendants or constituents of negotiability, or negotiation. That may exist without them." Strong, J., in Shaw v. Railroad Co., 101 U. S. 557, 563 (1879). See also Anderson v. Portland Flouring Mill Co., 37 Ore. 483, 489, 60 Pac. 839, 842 (1900). The ancient example is cited that an overdue promissory note is "negotiable" but a transferee nevertheless takes subject to defenses and equities.

[16] Bills of lading. N. Y. PERSONAL PROPERTY LAW, art. 7 (Uniform Bills of Lading Act) §§ 214-224. Warehouse receipts. N. Y. GENERAL BUSINESS LAW, art. 9 (Uniform Warehouse Receipts Act) §§ 121-131. Stock certificates are usually referred to as quasi-negotiable. Aigler, *op. cit. supra* note 12, at 584; N. Y. PERSONAL PROPERTY LAW, art. 6 (Uniform Stock Transfer Law) §§ 162-172.

[17] As in the case of bills, notes and other instruments negotiable within the meaning of the N. I. L. *Cf.* Odell v. Gray, 15 Mo. 337, 342 (1851); BIGELOW, BILLS, NOTES & CHECKS (3d ed. 1928) §§ 52-53. The word "negotiable" is sometimes used merely to indicate that the form of the instrument complies with the requirements of § 1 of the N. I. L.

makes it difficult to determine, at the very outset, what elements of "negotiability" were intended. In marked contrast to such acts as the Negotiable Instruments and Stock Transfer Laws, which set out in minute detail the particular qualities of the instruments governed, the present law declares in a most indefinite fashion in Section 261(3)[18] that:

"A person to whom title may be transferred, as in this section provided, and who shall have taken any such instrument from any other person for present or antecedent value and without notice of prior defenses or equities or claims of ownership enforceable against such other person, shall have absolute title thereto free of any defenses enforceable against or claims of ownership of the signer or any prior holder." [19]

The word "defenses" in the foregoing section of the amendment is a broad one, and, used in such an unqualified manner, may well be construed to include limitations placed upon the rights of the bondholders by the very terms of the bond. Corporations issuing bonds frequently limit their own liability with respect to the bondholders.[20] It seems likely and desirable that

[18] Other apposite sections are set forth below. § 261(1), *infra* note 36, provides for transfer of title of bearer instruments by delivery by any person in possession thereof; § 261(2), *infra* note 47, provides for transfer of title of instruments payable to a named person by indorsement followed by such delivery. § 261 (4), *infra* note 51, provides: ". . . this section [§ 261(1) (2) (3)] shall not be applicable . . ." to overdue instruments.

[19] The inartificiality of the statute is shown by the qualification of "absolute title" as "free of any defenses enforceable against . . . the signer." It seems impossible to invent a meaning for this. The signer does not sue upon his own bond; the holder neither needs nor has a defense to such a suit; and assuming the possibility of an occurrence of these two anomalies, why should a holder of "absolute title" be precluded from raising his defense?

Commenting on the Section as applied to security receipts, one writer has objected to the unfamiliarity of the phrase "antecedent value" and the omission of "equities" in the enumeration of immunities attaching to an "absolute title." Note (1926) 26 COL. L. REV. 884, 886-87. The latter objection seems met by the same writer's suggestion that "defenses" include "equities."

[20] In Enoch v. Brandon, *supra* note 5, for example, there was a provision allowing 75% of the holders to sanction the release of the company and mortgaged property from the principal and interest due, and to alter the rights of the bondholders against the company. Or there may be a provision that the time of payment may be extended on some contingency, as in McClelland v. Norfolk Southern R. R., *supra* note 4; or that members of a joint-stock association shall incur no personal liability on the issue, as in Hibbs v. Brown, *supra* note 8; or that no foreclosure suit shall be brought by the holders, except through the trustee on request of a named proportion of the holders, as in McGeorge v. Big Stone Gap Imp. Co., 57 Fed. 262 (C. C. W. D. Va. 1893); or that interest is payable out of income as declared by the directors, as in Strauss v. United Telegram Co.,

such limitations will be regarded as "defenses" in so far as notice thereof on the face of a corporate bond will be required in order for a corporation successfully to limit its liability against remote transferees. But if such limitations be regarded as "defenses," under the wording of the amendment, there arises the possibility that no purchaser may take such a bond "free of any . . . claim of ownership of . . . any prior holder" since "absolute title" is conditioned upon a taking "without notice of prior defenses . . . enforceable against" his transferor.[21] Similarly, notice, actual or constructive, of some partial defense of the corporation, such as a very slight failure of consideration, might leave a purchaser in the best of good faith without "title" sufficiently "absolute" to resist hidden claims of ownership on the part of others in the chain of prior holders.[22]

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164 Mass. 130, 41 N. E. 57 (1895) and Corcoran v. Chesapeake & Ohio Canal Co., 8 D. C. 358 (1874). In the cases cited *supra* notes 8 and 9, the balance sought to be struck throughout by the draftsmen lay between sufficient conformity with the N. I. L. to retain "negotiability" to make the bonds salable, sufficient security provision to induce bankers to underwrite the issue, and sufficient limitations on the liability of the corporation to protect it from embarrassment by sudden and heavy demands.

[21] This is particularly unfortunate, since the primary purpose of the law seems to have been to protect holders against claims of former ownership. The cases evidently calling the law into being questioned the title of a holder in due course as against a former owner from whom the instrument was stolen; the same question is involved in most cases considering the negotiability of corporate bonds. Enoch v. Brandon, *supra* note 5; Manhattan Co. v. Morgan; Babcock v. National Surety Co., both *supra* note 3; Hibbs v. Brown; Interboro Brewing Co. v. Doyle, both *supra* note 8; Pratt v. Higginson; Dengler v. Paul; King Cattle Co. v. Joseph; Grosfield v. First National Bank; Manker v. American Savings Bank & Trust Co.; Jones v. American Savings Bank & Trust Co.; Montvale v. Peoples Bank; Adrian v. Whitney National Bank; Bank of California v. National City Co., all *supra* note 9. It is of course probable that courts will avoid this result, but uncertainty there surely is. Statutes are to be interpreted so as to effectuate the purpose of the legislature, and in this Act itself is the provision: "This article shall not be construed to limit or impair the negotiability or quasi negotiability (sic) by agreement or otherwise of any instrument whether or not defined herein." § 262. But since the legislature has expressly prescribed a condition to an "absolute title," a supposition as to intention does not entitle a court to overlook the explicit terms of a statute. As to the clause quoted, the meaning of "negotiability" is not given; it may be questioned whether it includes the creation in a purchaser of a title free from claims of ownership. *Cf.* note 15 *supra*. Contrast the more specific and restricted wording of N. I. L. § 52.

[22] A possible remedy for this result would be a provision in the bond "whereby any and all holders forego and renounce their equities in favor of later holders for value without notice" of such equities or claims of ownership, as suggested though not passed on by Cardozo, C. J., in Manhattan Co. v. Morgan, *supra* note 3, at 50, 150 N. E. at 598. Its effectiveness, however, may well be doubted. See American National Bank v.

Section 261(3) omits any requirement of good faith in the purchaser. In this respect, the Section differs from the common law and is not in line with other statutes dealing with the effect of "negotiation" of documents.[23] The whole question is reduced to one of notice. Whether such a change is an improvement in the law may be doubted. For the affirmative, it may be argued that it avoids inquiry into a state of mind; but the answer is that in any case the subjective inquiry is generally to be determined by consideration of objective acts. On the other hand, the change emphasizes questions as to what constitutes notice, actual or constructive, and appears to protect a purchaser who, though without notice of defenses or equities as specified in the Act, buys in the utmost bad faith.[24]

As already indicated, Section 261(3) provides that one qualifying as a holder of "absolute title" of a corporate bond takes "free of *any* defenses enforceable against or claims of ownership of . . . any prior holder." (Italics ours). This would seem to abolish any "real defense" of either the maker or the indorser. As to defenses of the corporation maker against prior holders, it seems reasonably certain that the Act does not evidence an intent on the part of the legislature to include in the word "defenses" situations in which the bond is totally void or never had any valid inception, as in the case of forgery.[25] It seems

Sommerville, 191 Cal. 364, 216 Pac. 376 (1923), and Enoch v. Brandon, *supra* notes 5 and 7.

[23] N. I. L. § 52 (N. Y. NEGOTIABLE INSTRUMENTS LAW § 91): "A holder in due course is a holder who has taken the instrument . . . (3) . . . in good faith. . . ." UNIFORM BILLS OF LADING ACT § 38 (N. Y. PERSONAL PROPERTY LAW § 224): "The validity of the negotiation of a bill is not impaired . . . if the person to whom the bill was negotiated . . . gave value therefor, in good faith. . . ." The UNIFORM WAREHOUSE RECEIPTS ACT § 47 omitted the requirement but it appears in the amendments thereto and, since 1924, in N. Y. GENERAL BUSINESS LAW § 131: "The validity of the negotiation is not impaired . . . if the person to whom the receipt was negotiated paid value therefor, in good faith. . . ." The UNIFORM SALES ACT § 38 (N. Y. PERSONAL PROPERTY LAW § 119) omits the requirement also, but by the Sales Act Amendments such requirement will be added, to read: "The validity of the negotiation of a negotiable document of title is not impaired . . . if the person to whom the document was negotiated . . . paid value therefor in good faith. . . ." The UNIFORM STOCK TRANSFER ACT § 7 (N. Y. PERSONAL PROPERTY LAW § 168) provides: "If the indorsement or delivery of a certificate" is invalid ". . . possession . . . may be reclaimed and the transfer . . . rescinded, unless: (1) . . . transferred . . . for value in good faith. . . ."

[24] Doubt is thus cast on Morris v. Muir, *supra* note 8, where the defendant, who without inquiry bought stolen bonds from a thief, an immature and obviously degenerate boy of fifteen, was held liable for the value thereof to plaintiff from whom the bonds were stolen.

[25] It was so held before the Act. Maas v. Missouri, Kansas & Texas Ry., 83 N. Y. 223 (1880). Such a course of reasoning as to "real defenses" is suggested in BRANNAN, *op. cit. supra* note 4, at 433, and set forth in

somewhat conjectural, however, whether the "real defense" of alteration [26] may be similarly dealt with, for, although at common law alteration voided a negotiable corporate bond,[27] under the Negotiable Instruments Law alteration is generally denominated an affirmative "defense" [28] and an altered negotiable corporate bond, prior to this amendment, was not void but enforceable by a holder in due course according to its original tenor.[29] With respect to the contract of an indorser, whose indorsement not only transfers the ownership of a corporate bond [30] but also in a sense guarantees payment by the corporation maker,[31] there would seem to be little doubt but that Section 261(3) renders unavailable "real defenses," such as incapacity,[32] since the claim of total invalidity could hardly be advanced.[33] Furthermore, in the case of a forged indorsement, a court decision interpreting

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BIGELOW, *op. cit. supra* note 17, at § 509. This would admit of other "real defenses" under this Statute, such as statutory voidness or the situation previously covered by § 15 of the N. I. L. where an incomplete instrument was not validly delivered. There are, however, few "real defenses" ordinarily open to a corporate maker.

[26] Though this problem may not be a pressing one with respect to the carefully engraved issues of large corporate makers, it cannot be said categorically that it is of no importance to the many small corporations of the sort which issue a "typewritten debenture." This is only an example of details, formerly minutely provided for by the N. I. L., now left to the vagaries of future litigation.

[27] Greenfield Savings Bank v. Stowell, 123 Mass. 196 (1877); Aldrich v. Smith, 37 Mich. 468 (1877).

[28] Wagler v. Tobin, 104 Kan. 211, 178 Pac. 751 (1919); Commercial Security Co. v. Donald Drug Co., 112 S. C. 457, 100 S. E. 359 (1919); First National Bank v. Ford, 30 Wyo. 110, 216 Pac. 691 (1923).

[29] N. I. L. § 124.

[30] Despite the placing of this Act in the Personal Property Law, commented on in Note (1926) 12 CORN. L. Q. 97, bonds are not "title instruments" like bills of lading, an indorsement of which is only a requisite to negotiation and not a guaranty of performance by the issuer.

[31] Bonner v. City of New Orleans, Fed. Cas. No. 1631, at 853 (C. C. La. 1875); Connecticut Mutual Life Ins. Co. v. Cleveland, C. & C. R. R., 41 Barb. 9 (N. Y. 1863); Lane v. East Tennessee, Va. & Ga. R. R., 81 Tenn. 547 (1884); N. I. L. § 66; *cf.* N. I. L. § 65.

[32] As where the indorser is a lunatic, Wirebach Ex'r v. First National Bank, 97 Pa. 543 (1881) (not liable to a holder in due course); Anglo-Californian Bank v. Ames, 27 Fed. 727 (C. C. Neb. 1886) (disaffirmance against holder in due course); (Brumley v. Chattanooga Speedway & M. Co., 138 Tenn. 534, 198 S. W. 775 (1917) (disaffirmance); or an infant, N. I. L. § 22. It certainly makes it plain that an infant or lunatic cannot disaffirm the transfer and recover the instrument from subsequent holders in due course, as was allowed in Murray v. Thompson, 136 Tenn. 118, 188 S. W. 578 (1916), and Shipman Banking Co. v. Douglas, 206 Ill. App. 586 (1917). These cases are disapproved in BRANNAN, *op. cit. supra* note 4, at 180. But *cf.* BIGELOW, *op. cit. supra* note 17, at § 532.

[33] The instrument is valid, and the indorsement and delivery certainly not void inasmuch as they suffice to transfer the property.

the words "if indorsed" in Section 261(2)[34] to mean "if indorsed by the rightful owner or payee named therein" is evidently essential to make certain that a named owner or payee of a corporate bond shall be protected from losing his property through negotiation to a purchaser for value without notice of the forged indorsement.[35]

Section 261(1),[36] indicating that without exception a bond payable to bearer may be negotiated by delivery, leads to confusion as to the effect of a special or restrictive indorsement of such an instrument,[37] or of an indorsement under Section 332 of the New York Negotiable Instruments Law, allowing the holder of a negotiable bond to make it non-negotiable.[38] As Section 332 was not expressly repealed by the present law, the

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[34] Providing for transfer of title by delivery by anyone in possession of an order bond "if endorsed in blank, or . . . to a specified person. . . ." For the entire subsection see *infra* note 47.

[35] Such an objection seems to be answered by the apparent absurdity of the result. But a forged indorsement is sufficient to pass title in many European countries. See Embiricos v. Anglo-Austrian Bank, [1905] 1 K. B. 677; *cf.* British Bills of Exchange Act, 45 & 46 VICT. c. 61, § 60 (1882).

[36] "The title to any . . . corporate bond which by its terms entitles the bearer to the benefits thereof, may be transferred by the delivery thereof by any person in possession of the same howsoever such possession may have been acquired."

[37] A special indorsement by a holder cannot be said to be an "inclusion" in the bond of provisions "limiting the right of transfer" within the meaning of the last paragraph of § 260(3) providing: "For the purposes of this article, the character of any such . . . corporate bond is not affected by the inclusion therein of other provisions not limiting the right of transfer and the negotiable quality thereof as in this article provided." If it is such a limiting provision, and if the negative implication of the Section be correct—that such provisions will affect the character of a bond —then the logical result is that such an indorsement forever destroys "negotiability."

There is no answer to the question of what are and what are not "provisions not limiting the right of transfer and the negotiable quality thereof as in this article provided." See Note (1926) 26 COL. L. REV. 884, 885. Interpretation also awaits § 261(2), *infra* note 47, which requires that an order corporate bond, to be negotiable, must provide "in substance that title thereto is transferable with the same effect as in the case of a negotiable instrument." *Ibid.* 886. Both phrases present unfortunate opportunities for litigation.

[38] "The owner or holder of any corporate or municipal bond or obligation (except such as are designated to circulate as money, payable to bearer), heretofore or hereafter issued in and payable in this state, but not registered in pursuance of any state law, may make such bond or obligation, or the interest coupon accompanying the same, non-negotiable, by subscribing his name to a statement indorsed thereon, that such bond, obligation or coupon is his property; and thereon the principal sum therein mentioned is payable only to such owner or holder, or his legal representatives or assigns, unless such bond, obligation or coupon be transferred by indorsement in blank, or payable to bearer, or to order. . . ."

question arises which of the two will govern if a holder attempts to act under Section 332 to protect his ownership of a bearer bond. The earlier Statute expressly prohibits further negotiation without action by the owner; the Statute under discussion allows title to a bearer bond to be transferred "by any person in possession" thereof. The mere existence of such uncertainty is unfortunate, entirely apart from the question whether business convenience is served by having the promise to pay bearer or the indorsement control the transfer of the instrument.[39] The same sort of uncertainty arises as to the effect of a special indorsement of a bearer bond. It is to be hoped that Section 261(1) avoids the supposed conflict in the Negotiable Instruments Law between Section 9(5) [40] and Section 40 [41] by making special indorsements ineffective to control the future negotiation of bearer bonds,[42] but, as the Statute is not explicit, only future litigation will determine whether that result will follow.[43]

The amendment as a whole leaves the contract of the indorser in serious confusion. The inference is that corporate bonds, because given specified qualities of negotiability by this Act, are non-negotiable in all other respects, if not conforming with Section 1 of the Negotiable Instruments Law. Since no mention is made of the responsibility of indorsers, that question seems to be released to the confusion surrounding the responsibility

[39] That the indorsement of a special indorsee should be necessary for further negotiation of instruments originally payable to bearer, see Brannan, *Some Necessary Amendments to the Negotiable Instruments Law* (1913) 26 HARV. L. REV., 493, 500. This conception of business convenience seems the basis of the proposed amendment to the N. I. L. §§ 9 and 40. A later survey, however, demonstrated a strong feeling among bankers, bond houses and lawyers that a requirement of further indorsement of bearer paper already specially indorsed would encumber payment and transfer out of all proportion to the doubtful gain of cutting down losses. The opinion of banks and bond houses was unanimous to this effect in regard to bonds and coupons in particular. Turner, *A Factual Analysis of Certain Proposed Amendments to the Negotiable Instruments Law* (1929) 38 YALE L. J. 1047, 1050.

[40] "The instrument is payable to bearer. . . . (5) When the only or last indorsement is an indorsement in blank."

[41] "Where an instrument, payable to bearer, is indorsed specially, it may nevertheless be further negotiated by delivery. . . ."

[42] *Supra* note 39.

[43] § 261(3) may be cited to show a contrary intention. It provides that "any holder of any . . . corporate bond . . . shall be deemed prima facie to have title thereto as aforesaid [*i. e.* absolute title] unless the same has been endorsed to a specified person other than the holder and has not been endorsed in blank by such specified person. . . ." Thus a person, other than the special indorsee, in possession of a specially indorsed bearer bond is not presumed to have title. But the term "holder" which is nowhere defined seems quite broad and is at least used in contradistinction to special indorsee, and the application of this provision is quite ambiguous.

of indorsers on non-negotiable instruments.[44] Frequently another interested corporation, a county or community, will indorse an issue of corporate bonds before delivery as an inducement to purchase.[45] If a corporate bond so indorsed be non-negotiable, liability of the indorser will, of course, result; but the conflict in the measure thereof has been termed irreconcilable.[46] It is true that ordinarily such responsibility on bonds is clearly spelled out and delimited, but a point of such commercial importance should not be subjected to uncertainty in law.

Section 261(3) appears to preclude the payee named in an order bond from having "absolute title" as provided therein. It limits its protection to persons "to whom title may be transferred, as in this section provided. . . ." Section 261(2),[47] thus referred to, allows title to such a bond to be "transferred . . . if endorsed . . . and delivery is made. . . ." A "transfer" and endorsement is required before the holder of an order bond is protected, and delivery to a payee seems not sufficient. It was a strained interpretation of the Negotiable Instruments Law that led some courts to hold that a payee could not be a holder in due course,[48] and the lower New York courts seem to have repudiated that interpretation.[49] The new law, however, is far

[44] The results in this field vary all the way from holding the transferor of a non-negotiable instrument, not an accommodation party, to be liable prima facie as a maker, to holding the indorser to be merely an assignor of a contract chose in action, liable, if at all, in absence of contrary intent, only on implied warranties. Note (1927) 37 YALE L. J. 102.

[45] Higgins v. Hocking Valley R. Co., *supra* note 8; State v. Long Bell Lumber Co., 12 S. W. (2d) 64 (Mo. 1928).

[46] Comment (1927) 37 YALE L. J. 102, 107.

[47] "The title to any . . . corporate bond which, by its terms, entitles a person named therein to the benefits thereof and which provides, in substance, that title thereto is transferable with the same effect as in the case of a negotiable instrument, may be transferred by delivery thereof by any person in possession of the same, howsoever such possession may have been acquired if endorsed in blank, or if it is endorsed to a specified person and the delivery is made to such person."

[48] N. I. L. § 52 defines a holder in due course as "a holder who . . . (4) . . . at the time [the instrument] was negotiated to him . . . had no notice of any . . . defect in the title of the person negotiating it." This was said to mean that a "negotiation" as defined in § 30 (substantially similar to § 261(1) (2) in this Act) was a condition precedent to the status of a holder in due course. The conflicting cases are collected and discussed in BRANNAN, *op. cit. supra* note 4, at 361-372, 119-127 and analyzed and compared in Aigler, *Payees as Holders in Due Course* (1927) 36 YALE L. J. 608. See also Comment (1927) 36 YALE L. J. 1005.

[49] Brown v. Brown, 91 Misc. 220, 154 N. Y. Supp. 1098 (City Ct. 1915); Bergstrom v. Ritz-Carlton Restaurant & Hotel Co., 171 App. Div. 776, 157 N. Y. Supp. 959 (1st Dep't 1916); see Miller v. Campbell, 173 App. Div. 821, 824, 160 N. Y. Supp. 834, 840 (1st Dep't 1916); Empire Trust Co. v. Manhattan Co., 97 Misc. 694, 698 *et seq.*, 162 N. Y. Supp. 629, 632

more explicit in requiring "negotiation." It can only be hoped that the literal wording will not be followed to its logical conclusion.[50]

Section 261(4),[51] in providing that Section 261 is not applicable to transfers made after the date fixed for performance, is evidently designed to limit the protection of the Act to transfers before maturity. It appears capable of being interpreted to upset the rule, well settled at common law and under the Negotiable Instruments Law, that the presence on a bond of unpaid, overdue interest coupons does not alone prevent the transferee of the bond from being a holder in due course.[52] The promise to pay interest in the coupon is probably to be construed as one of the signer's obligations on the bond.[53] Transfer of bonds after the due date of such attached coupons is made only "after the date fixed therein for the performance by the signer of his obligations thereunder." If Section 261 [54] is then no longer ap-

et seq. (Sup. Ct. 1916), *aff'd* without opinion, 180 App. Div. 891, 166 N. Y. Supp. 1093 (1st Dep't 1917); *cf.* Carnegie Trust Co. v. First National Bank, 213 N. Y. 301, 107 N. E. 693 (1915). But *cf.* Hathaway v. County of Delaware, 185 N. Y. 368, 78 N. E. 153 (1906); see also Cohen v. Rossmoore, 225 App. Div. 300, 304, 233 N. Y. Supp. 196, 199 (1st Dep't 1929).

[50] It would be regrettable if, where a debtor buys bonds payable to his creditor and has them remitted to his creditor as payment of his debt, the creditor-payee should be subject to a defense of fraud or failure of consideration which the signer may have against the debtor-remitter. To avoid this result under the N. I. L. the Commissioners on Uniform State Laws propose the following amendment to the N. I. L. § 52: "A holder in due course is a payee or other holder. . . ." NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK (1929) 237. Corresponding changes are suggested for §§ 16 and 30. *Ibid.* 235, 236. For the draftsman's comment on the changes, see *ibid.* 244.

[51] "The provisions of this section shall not be applicable to the transfer of any . . . corporate bond, when it is shown that such transfer was made after the date fixed therein for the performance by the signer of his obligations thereunder or, if no date is fixed, after the expiration of a reasonable time after the happening of the contingency upon which the signer became obligated to perform."

[52] Buffalo Loan, T. & S. D. Co. v. Medina Gas Light Co., 162 N. Y. 67, 56 N. E. 505 (1900); Cromwell v. Sac County, 96 U. S. 51 (1877); Indiana & Ill. Cent. Ry. v. Sprague, 103 U. S. 756 (1880). The reasoning is plain. Unpaid coupons on bonds do "not necessarily constitute notice of any invalidity in the bonds." Grand Rapids & Ind. R. R. v. Sanders, 54 How. Prac. 214, 221 (N. Y. 1877).

[53] By definition a corporate bond includes "any interest coupon appertaining to any" corporate bond. § 260(3). Even if the promise in the coupon is held not to be the signer's "obligations" under the bond within the meaning of § 261(4), the promise to pay interest on certain dates, customarily first made in the bond itself, would seem to come within the Section.

[54] Providing in substance for transfer of bearer bonds by delivery, subsection (1), *supra* note 36, of order bonds by indorsement and delivery,

plicable,[55] the bonds are divested of the important attributes of negotiability provided for in the article.[56] Of course this result may be avoided by construing the signer's "obligations thereunder" to mean only his final and chief obligation to pay the principal at maturity, but again the matter is left uncertain. The effect of Section 261(4) also appears vague when its application to acceleration provisions is considered, since it might mean that the happening of an event maturing a bond would render it overdue and thus make Section 261 inapplicable. Yet except in the rare case of a perpetual bond bearing no maturity date, it can probably be said that transfers of bonds made after acceleration are not made "after the date fixed therein for the performance by the signer of his obligations thereunder" because the "date fixed therein" has not passed, and that the previous "happening of the contingency upon which the signer became obligated to perform" is inoperative to take the transfer out of the protection of Section 261 because a specified final date for performance was fixed in the bond.[57]

Piecemeal legislation as a rule has little to commend itself, especially on a subject of such commercial importance.[58] Ap-

subsection (2), *supra* note 47, and for protection of the title of a purchaser for value without notice, subsection (3), *supra* p. 266.

[55] This would seem to be possible, even if the bonds did not have the unpaid coupons still attached, where the bonds themselves contained promises to pay the interest on certain dates, as "on the first days of January and July of every year until maturity," which promises were unfulfilled.

[56] Only the saving clause in § 262, *supra* note 21, operates to protect the negotiable qualities assured to bonds by § 261(1) (2). Any other result, though logical, is absurd. Mere transferability is an attribute of substantially all contract rights under modern common law. BIGELOW, *op. cit. supra* note 17, at § 52.

[57] This interpretation would protect the purchaser without notice of the acceleration, which is presumably commendable, but on the same interpretation even if a transferee had notice that the bond was overdue by reason of acceleration of maturity he would not for that reason take subject to defenses or claims of ownership. In this respect, the present law goes well beyond the amendment to the Negotiable Instruments Law proposed by the Commissioners on Uniform State Laws for the protection of innocent purchasers of negotiable instruments matured by acceleration. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK (1929) 237. Although much can be said in approval of the use of acceleration provisions, it is doubtful whether a purchaser with notice that a corporate bond has been accelerated is entitled to the protection this amendment would apparently give him.

[58] Note (1926) 26 COL. L. REV. 884, 891. Professor Williston, refusing in his report to the Conference of Commissioners to incorporate in the amendment to the N. I. L. a provision such as the Hofstadter Act, which would make security receipts negotiable, wrote: "But there is a variety of other instruments besides receipts for securities which are by banking custom negotiable. It would be difficult to enumerate them satisfactorily even under present practice, and future banking customs may readily en-

parently general uncertainty has been substituted for the earlier uncertainty which was primarily confined to the one point of form. Even granting some necessity for immediate action, it is felt that better means of insuring the negotiability of corporate bonds were available. A careful definition of corporate bonds followed by provisions to the effect that such securities, so defined, should be negotiable within the meaning, and according to the limitations and provisions, of the Negotiable Instruments Law, irrespective of whether such securities comply with the formal requisites of the Negotiable Instruments Law, would have been more effective.

APPORTIONMENT BETWEEN PRINCIPAL AND INCOME OF PROCEEDS DERIVED FROM THE SALE OF UNPRODUCTIVE REALTY HELD IN TRUST

THE conflict between the interest of life tenant and remainderman in the administration of a trust estate has long been a fertile source of litigation.[1] Particularly troublesome has been the allocation between principal and income of the carrying charges and proceeds derived from the sale of unproductive real estate. The recent case of *Creed v. Connelly*[2] illustrates the typical problem and one possible solution.

The testator left the residue of his estate in trust, income to be paid to his wife, remainder on her death or remarriage to other relatives. Part of this estate consisted of unimproved land which was carried at a loss for ten years. The difference between the carrying charges and the rental received was deducted from the other income of the life tenant. When the land was finally sold at a price well above the appraised value at the time of the testator's death, the life tenant asked that she be reimbursed out of the proceeds of sale for the loss of income which she had suffered. Finding no evidence in either the will itself or in extraneous facts that the testator intended an immediate conversion, the court held that the life tenant was not entitled to share in the proceeds of sale.

In thus seeking to establish the intention of the testator, the court adopted the customary approach. The inquiry may be determined by the words of the will itself. Particularly conclusive is a direction that the unproductive real estate should be

large the list." NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK (1929) 241.

[1] *Cf.* LEWIN, TRUSTS (13th ed. 1928) 277-293; UNDERHILL, LAW OF TRUSTS AND TRUSTEES (8th ed. 1926) 231-240; 2 PERRY, TRUSTS AND TRUSTEES (6th ed. 1911) c. 18; Note (1921) 13 A. L. R. 1004.

[2] 172 N. E. 106 (Mass. 1930).

immediately converted into a productive fund. Even though the sale is justifiably delayed, the property is regarded as legally converted from the time of the testator's death or one year thereafter.[3] The life tenant is therefore reimbursed out of the proceeds of sale for the loss of income which the actual delay has caused.[4] This fiction applies both to personalty and realty and is part of the doctrine of equitable conversion.[5]

More usual and less decisive than a direction to sell is a clause giving the trustees power to sell and reinvest at their own discretion. Sometimes this is interpreted as granting authority to postpone only for a convenient time the sale of unproductive real estate, thus justifying the application of the doctrine of equitable conversion.[6] Such an interpretation seems almost certain of adoption if the predominance of unproductive realty entirely deprives the life tenant of actual income.[7] So also if the court is convinced by other terms of the will that the life tenant would otherwise receive substantially less than the testator expected.[8] When these considerations are inconclusive, subor-

[3] The rights of the life tenant to income during the first year after the testator's death depend on many factors not material to this discussion. *Cf.* LEWIN, *op. cit. supra* note 1, at 281; Taylor v. Clark, 1 Hare 161 (1841); Equitable Trust Co. v. Kent, 11 Del. Ch. 334, 101 Atl. 875 (1917).

[4] Edwards v. Edwards, 183 Mass. 581, 67 N. E. 658 (1903). The testator gave all his property to trustees: "To invest and reinvest the same at their discretion in such securities as the laws of this Commonwealth allow savings banks to invest their funds in." The court said: "Under language like that of this will, which gives the trustees all the property, real and personal, and does not indicate an intention that the time for establishing the fund shall be postponed, and which gives to a life tenant the annual income, it is well settled law in this Commonwealth that income is to be compounded from the time of the testator's death." 183 Mass. at 583, 67 N. E. at 659.

[5] See Yates v. Yates, 28 Beav. 637, 639 (1860); Jordan v. Jordan, 192 Mass. 337, 345, 78 N. E. 459, 461 (1906); UNDERHILL, *op. cit. supra* note 1, at 253; PERRY, *op. cit. supra* note 1, at 548 n.a.

[6] Furniss v. Cruikshank, 230 N. Y. 495, 130 N. E. 625 (1921). The testator authorized the trustees to sell or lease any lands comprised in the trust. There was a further clause in the will reading: "I hereby declare that all the powers herein given are intended to be discretionary and to be exercised or not as the said executors and trustees shall think proper." This was interpreted as an "imperative power" to sell unproductive realty with discretion as to the time of sale. But the equitable income granted to the life tenant did not begin until two years after the testator's death.

[7] *Cf.* Furniss v. Cruikshank, *supra* note 6; Lawrence v. Littlefield, 215 N. Y. 561, 109 N. E. 611 (1915); Edwards v. Edwards, *supra* note 4.

[8] Ogden v. Allen, 225 Mass. 595, 114 N. E. 862 (1917). The testator directed that his widow should receive $4,000 annually out of the net income of the estate but the estate never realized $4,000 a year. The court approved an apportionment of proceeds realized before the death of the widow, but denied it on proceeds realized after her death.

dinate factors, such as degree of kinship to the testator, may aid in determining whether life tenant or remainderman should be preferred.[9]

When the life tenant can offer no affirmative evidence of the testator's favor, there is little likelihood that an apportionment will be decreed.[10] Absence of such evidence is apparently regarded as proof that no apportionment was intended, particularly if, as in *Creed v. Connelly*, not even power of sale has been conferred. But the number of variable factors from which the intention of the testator may be implied makes any sweeping generalization dangerous. The frequency of reversals of the trial court's interpretation also indicates the difficulty of prediction.[11]

Even the classification so far suggested is disturbed when the inquiry is extended to the allocation of the carrying charges of unproductive realty. According to the general rule, the recurrent costs of a trust estate must, in the absence of the testator's direction to the contrary, be charged to income.[12] But the same facts which imply an intention for the apportionment of proceeds of sale, may be used to justify a decree that the carrying charges of unproductive realty be charged to principal.[13] Such relief may be even more beneficial to the life tenant than an apportionment, since it shifts the burden of financing the property until a sale is accomplished. Sometimes the life tenant triumphs in both respects, sharing in the pro-

[9] See Furniss v. Cruikshank, *supra* note 6, at 504, 130 N. E. at 627; Lawrence v. Littlefield, *supra* note 7, at 569, 109 N. E. at 613; Creed v. Connelly, *supra* note 2, at 108. It is usually argued that the life tenant is the object of the testator's particular solicitude; this argument is of course strengthened if the life tenants are children of the testator and the remaindermen are grandchildren not yet in existence.

[10] Yates v. Yates, *supra* note 5; Jordan v. Jordan, *supra* note 5 (the court noted that the income was adequate and the life tenants not dependent upon the testator); Patterson v. Vivion, 63 Misc. 389, 117 N. Y. Supp. 504 (1909); Parkhurst v. Ginn, 228 Mass. 159, 117 N. E. 202 (1917) (the actual income was sufficient to pay the maximum provided by the testator).

[11] *Cf.* Creed v. Connelly, *supra* note 2; Furniss v. Cruikshank, *supra* note 6. These reversals seem to be based not so much on errors of law as on a difference in the interpretation of the testator's intention.

[12] BOGERT, TRUSTS (1921) 375.

[13] Matter of Vermilye, 100 Misc. 235, 166 N. Y. Supp. 320 (1917); Spencer v. Spencer, 219 N. Y. 459, 114 N. E. 849 (1916). In these cases the carrying charges were so large as to deprive the life tenant of all other income. Also Patterson v. Old Dominion Co., 149 Va. 597, 140 S. E. 810 (1927) (the trustee was authorized to sell the corpus of the estate if necessary for the support of the life tenant); Matter of Lichtenberg, 114 Misc. 89, 185 N. Y. Supp. 913 (1921) (testator directed that no part of estate should be invested in unimproved property); Note (1922) 17 A. L. R. 1384, 1394.

ceeds though relieved of the costs.[14] In other cases the question of carrying charges has been separately presented and resolved, without inquiry concerning the testator's intention, in favor of the life tenant.[15] In one case, the court after confidently expressing its conviction that the testator desired no apportionment, ordered that the costs of the same property be charged to principal.[16] Thus there seem to be four current solutions to the problem of unproductive realty. The life tenant seems likely to receive at least one of the two possible types of relief described; but he may receive both or neither. Beyond this, even for a given jurisdiction, it seems foolhardy to venture a prediction.

This uncertainty seems to follow naturally upon the attempt to suit the decision to the intention of the testator. Unfortunately since that intention is seldom expressed, there is little guarantee that it is often realized. A definite rule would eliminate much futile guesswork and provide a more convincing basis for decision. A testator who did not desire the application of the accepted rule would be likely to express his contrary intentions; his silence could be reasonably regarded as acquiescence. As a result his intentions would be less debated and more often fulfilled. The duty of the trustee would be plain. And the problem would no longer haunt the courts, wasting in litigation the substance of the estate, sometimes dragging through appeals and reversals many years after the death of the life beneficiary.[17]

These considerations seem to commend recent efforts to popularize a simple and workable rule. Such a rule seems to be embodied in Section 12 of the Uniform Principal and Income Act[18] which provides that, in the absence of a contrary direction in the will, the proceeds of a delayed sale of unproductive

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[14] Furniss v. Cruikshank, *supra* note 6; Lawrence v. Littlefield, *supra* note 7; Ogden v. Allen, *supra* note 8.

[15] Poole v. Union Trust Co., 191 Mich. 162, 157 N. W. 430 (1916); In re Marten's Estate, 16 Misc. 245, 39 N. Y. Supp. 189 (1896); Matter of Pitney, 113 App. Div. 845, 99 N. Y. Supp. 588 (1st Dep't 1906) (unproductive real estate acquired by foreclosure).

[16] Hites Devisees v. Hites Executors, 93 Ky. 257, 20 S. W. 778 (1892).

[17] *Cf.* Creed v. Connelly, *supra* note 2; Furniss v. Cruikshank, *supra* note 6; Spring v. Hollander, 261 Mass. 373, 158 N. E. 791 (1927); Ogden v. Allen, *supra* note 8. In all these cases the life tenant was dead when the final decision was rendered.

[18] NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, PROGRAM AND COMMITTEE REPORTS, UNIFORM PRINCIPAL AND INCOME ACT, Third Tentative Draft prepared by Dean Charles E. Clark of Yale University School of Law (1930) 190, 198. Substantially the same rule is adopted in the tentative drafts of the RESTATEMENT OF THE LAW OF PROPERTY (1930) Preliminary Draft No. 33, § 164, and RESTATEMENT OF THE LAW OF TRUSTS (1930) Preliminary Draft No. 20, §§ 221, 222.

realty should be apportioned as follows: to principal that sum which, invested during the period of delay at a conservative rate of simple interest, would have produced the net sale price; to income the remaining portion of the proceeds of sale.[19] The period of delay is defined as beginning when the sale "first could have been reasonably made, which is presumed, in the absence of evidence to the contrary, to be one year after the trustee first received the property, if then unproductive, or one year after it ceased to produce income, if it later became unproductive." The Act applies whether the will directs, authorizes or makes no mention of a sale. Thus it adopts one of the four current solutions of the problem for all of the situations here discussed. It is completely in harmony with the cases in which an apportionment is directed,[20] and fundamentally in harmony with decisions which relieve the life tenant of the carrying charges of unproductive realty; it does not go so far as the cases which give both types of relief,[21] and is contrary only to decisions like *Creed v. Connelly* which afford the life tenant no relief.

But these last cases seem to have little justification either in reason or authority. They are, for example, directly opposed to the rules usually applied to personalty. When the residue of a trust estate contains a reversionary interest, which yields no present return but promises a lump sum in the future, it is the duty of the trustee to convert that sum as soon as possible into a productive investment.[22] In case of a justifiable delay, the life tenant is reimbursed out of the sum finally realized by

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19 Unproductive realty is defined by the Act as land which, for a period of more than one year, does not produce income amounting to more than one per centum per annum of its value. The Act also provides that: "If the tenant has received any income from the property, or has had any beneficial use thereof, during the period while the sale has been thus delayed, his share of the delayed income shall be reduced by the amount of such income received, or the value of the use had." For a "conservative" rate of interest the Act suggests 4 or 5 per centum per annum.

20 Besides in the situations already discussed, an apportionment is usually decreed when the unproductive realty has been acquired by the foreclosure of a mortgage. In re Atkinson, [1904] 2 Ch. 160; Parker v. Seeley, 56 N. J. Eq. 110, 38 Atl. 280 (1897); Park's Estate, 173 Pa. 190, 33 Atl. 884 (1896).

21 § 12 of the Act also provides that: "During the period while the sale is delayed all expenses in connection with the property shall be paid out of principal, but such of them as would have been chargeable to income had the property been productive shall be repaid with simple interest at the legal rate out of the delayed income."

22 "Express trusts for conversion must of course be strictly pursued according to the directions. . . . But besides express trusts of this kind there is frequently imposed upon trustees a duty to convert, not directed in terms, but arising out of the nature of the property, and the relation in which the cestuis que trust stand to each other." LEWIN, *op. cit. supra* note 1, at 277.

conversion for the loss of income which he has suffered.[23] Nor need he show a direction for conversion or other evidence of the testator's intention in order to prove his right to this equitable income.[24] Conversely when the residue of the estate consists of annuities, unauthorized securities or speculative business investments, all yielding present returns but jeopardizing or diminishing the interests of the remaindermen, they must be converted into conservative investments.[25] In case of delay the life tenant is entitled not to actual but only to equitable income,[26] and must refund whatever excess he has received.[27] The basic assumption of all these cases seems to be that the testator intends neither life tenant nor remainderman to profit at the expense of the other.[28]

Directly opposed to this principle is the presumption indulged in *Creed v. Connelly* that the testator intended the life tenant to suffer a loss of income in order that the remainderman might reap the benefits of a rise in real estate values. It is believed that this anomaly has been developed and perpetuated by virtue of a misconception. It is generally agreed that the life tenant is entitled to the actual income of productive real

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[23] Westcott v. Nickerson, 120 Mass. 410 (1816) (partnership); Fearus v. Young, 9 Ves. 549 (1805) (life estate); Wilkinson v. Duncan, 23 Beav. 469 (1857) (reversion); Greene v. Greene, 19 R. I. 696, 36 Atl. 714 (1901) (banking investments); Hagan v. Platt, 48 N. J. Eq. 206, 21 Atl. 860 (1891) (mortgage foreclosure); Holebone v. Holebone, [1919] 2 Ch. 93 (installment payments).

[24] If there is evidence that the testator did not intend an apportionment, the life tenant must of course produce rebutting evidence or lose his case. But the initial burden of proof rests upon the representatives of the remainderman because the nature of the property raises a presumption in favor of an apportionment. *Cf.* UNDERHILL, *op. cit. supra* note 1, at art. 48.

[25] Howe v. Dartmouth, 7 Ves. 138 (1802) (unauthorized, 5% securities); Morgan v. Morgan, 14 Beav. 72 (1851). Similar cases are collected and discussed in 2 WHITE & TUDOR, LEADING CASES IN EQUITY (1928) 69 (notes to Howe v. Dartmouth, *supra*); Mills v. Mills, 7 Sim. 501 (1835) (leaseholds, stocks and annuities); LEWIN, *op. cit. supra* note 1, at 278.

[26] In Howe v. Dartmouth, *supra* note 25, the method of computing equitable income is to calculate the value of authorized securities which could have been obtained by conversion one year after the testator's death, giving the life tenant the income which these securities would then have earned until the actual conversion.

[27] Although the estate has suffered no loss by the delay in conversion, and has apparently profited by it, the life tenant must refund any excess income he has received. Dimes v. Scott, 4 Russ. 195 (1828).

[28] The rational bases of these cases is well expressed in Wilkinson v. Duncan, *supra* note 23, at 472: "The trustees delayed to sell the reversion until it had fallen into possession because they were of the opinion that, by so doing, they would in the end produce a larger amount to the estate of the testator. They acted properly in so doing, but they ought not thereby to injure one of the legatees of that trust fund for the benefit of others, and it is to be presumed that they in no way intended to do so."

estate.[29] From this it seems to have been inferred that if the actual income is nothing the life tenant gets nothing; that it would be inconsistent to allow actual income on productive realty and equitable income on unproductive realty.[30] This argument is fallacious because the productivity of real estate does not diminish or endanger the interests of the remainderman, whereas its unproductivity does diminish the interest of the life tenant. Unproductive realty is an improper trust investment not because of its realty, but because of its unproductivity.[31] Consequently there is no inconsistency in giving even the same life tenant the actual income of productive real estate and the equitable income, *i.e.*, a share in the proceeds of sale, of unproductive real estate.[32]

Not only does the rule of *Creed v. Connelly* seem mistaken in theory, but it also leads to unfortunate practical consequences. The trustee is often placed in a position where he cannot possibly fulfill his duty to act impartially between life tenant and remainderman. Either he must subject the life tenant to the loss of income consequent upon delay, or he must sell hurriedly at the low figures which usually attend hasty liquidation, thus sacrificing the interests of the remainderman. The life tenant will often press for the latter course and may obtain a court order directing it.[33] Thus an unnecessary conflict of interest

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[29] In re Searle, [1900] 2 Ch. 829; Hope v. d'Hedouville, [1893] 2 Ch. 361; In re Earl of Darnley, [1907] 1 Ch. 159. These last two cases depart from the rule applied to personalty. Although a conversion was directed in the will, the court allowed the life tenant the actual income during the period of delay.

[30] The argument is articulated in Martin v. Kimball, 86 N. J. Eq. 10, 15, 96 Atl. 565, 567 (1916). The land devised was partly productive and partly unproductive. The will directed the trustees to convert the land into cash but also provided that the life tenant should have the rents actually produced. The unimproved real estate was carried for a time by the trustees and then sold as building lots. The court refused an apportionment of the proceeds, saying: "If the testatrix intended her husband to enjoy the rents that negatives the idea that she intends him to enjoy notional [equitable] income. If she gave him rents she cannot be deemed to contemplate a condition of the property in which there will be no rents. No court has held that he can have both."

[31] Bogert suggests that it is inadvisable for a trustee to invest in real estate, productive or unproductive. But in the absence of a clause in the will directing a sale, there is no duty to sell productive real estate, as there is for example to sell annuities and unauthorized securities. *Cf.* BOGERT, *op. cit. supra* note 12, at 359.

[32] In a recent surrogate's case in New York the life tenant seems to have been given the actual income of productive realty and a share in the proceeds of unproductive realty. The facts are unfortunately not clearly reported. Matter of Hopkins, 133 Misc. 554, 233 N. Y. Supp. 326 (1929).

[33] In Spring v. Hollander, *supra* note 17, the court refused an apportionment on the ground that under the existing state statute, R. L. c. 127 §

prevents a peaceful and economical management of the trust. It is by insuring the life tenant of a share in the profits of delay that the rule of the Uniform Act would eliminate this conflict and encourage far-sighted and harmonious trust administration.

THE AFFECTING OF FARMERS' COOPERATIVES WITH THE PUBLIC INTEREST

THE legal status of cooperative associations has once more been brought to the fore in a series of interesting cases. These cases all center about Oklahoma statutes dealing with cooperative organization in a particular industry—cotton ginning. The fundamental principles underlying all forms of cooperative enterprise are so similar, however, that the decisions of the courts in this limited sphere may fairly be taken as representative of the judicial attitude towards the movement in general.[1]

A detailed study of the background in which these cases are set is necessary at the outset in order properly to gauge their significance as a part of the growing body of law dealing with cooperative enterprise. The part which cotton ginning plays in the processing of cotton made it peculiarly adaptable to the development of cooperative ventures. Cotton gins perform a service indispensable to the preparation of raw cotton for marketing. Until recent years they have been operated by individual ginners who were independent of the grower and unmindful of his economic welfare. Since a grower often had access to but one gin, there was frequently neither an effective check upon the charge made for ginning nor any assurance of efficiency. The result was an exploitation of the grower which cut deep into his profits.[2] The evils attendant upon this state of monopolistic competition led Oklahoma to pass a law making gins "public utilities," [3] and empowering the state Corporation Commis-

28-31, the life tenant could have initiated an earlier sale. This argument only accentuates the undesirability of such decisions.

[1] For detailed accounts of the history and development of the cooperative movement in this country see NOURSE, THE LEGAL STATUS OF AGRICULTURAL COOPERATION, (1927) and STEEN, COOPERATIVE MARKETING (1923); for a study of its status abroad see FAY, COOPERATION AT HOME AND ABROAD (1925).

[2] A vivid picture of the cotton grower's need of some form of organization to increase his bargaining power and thereby enable him to solve more satisfactorily his economic problems appears in MONTGOMERY, THE COOPERATIVE PATTERN IN COTTON (1929).

[3] The statute declared gins to be "public utilities," and their operation for the purpose of ginning seed cotton "a public business." OKLA. COMP. STAT. (1921) § 3712.

sion to establish rates and regulations for their operation.[4] Subsequently, when the spread of the doctrine of cooperative organization taught growers to form associations to gin their own cotton, other statutes were passed granting special privileges to these organizations.[5] The power to regulate the industry having been assumed, these later statutes followed as a matter of course.[6]

From 1917 to 1928 cooperative ginning associations flourished under the protection thus afforded them by the Legislature.[7] In 1928, however, the Supreme Court of the United States in *Frost v. Corporation Commission of Oklahoma*[8] held unconstitutional a statute passed in 1925 which permitted cooperative ginning associations to procure licenses to operate from the Commission on terms more favorable than those allowed commercial ginners.[9] The statute had conferred this privilege on all cooper-

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[4] OKLA. COMP. STAT. (1921) § 3712; § 3713 (as amended by Okla. Laws 1923, c. 191, p. 340); § 3714 (as amended by Okla. Laws 1925, § 1, c. 109, p. 157); § 3715 (as amended by Okla. Laws 1923, c. 191, § 3); §§ 3716-18.

[5] OKLA. COMP. STAT. (1921) § 5599, passed in 1917, authorized the formation of cooperative associations without capital stock and not conducted for profit. In 1919 this was enlarged, OKLA. COMP. STAT. (1921) §§ 5637-5652, to permit the formation of cooperatives with capital stock. The statutes conferring upon the cooperatives special privileges, in particular the right to receive a license on the presentation of a petition signed by 100 citizens and taxpayers, and the right to declare "patronage dividends," will be discussed in detail in the body of this comment.

[6] Aside from public utilities and common callings, only those businesses which are held to be affected with the public interest are subject to such drastic public interference as price regulation. Munn v. Illinois, 94 U. S. 113 (1876). Accordingly, the device used by legislatures to prepare the way for the regulation of an industry has been to declare it affected with a public interest. If the affectation is held valid, then regulation will be permitted. For a history of the cases bearing on this subject see Hamilton, *Affectation with Public Interest* (1930) 39 YALE L. J. 1089; McAllister, *Lord Hale and Business Affected with a Public Interest* (1930) 43 HARV. L. REV. 759. The Oklahoma Legislature was thus but following a time-honored formula.

[7] The following cases assumed the validity of the statutes making ginning a public business, and upheld the Commission's regulatory powers: Sims v. State, 80 Okla. 254, 196 Pac. 132 (1921); Planters' Cotton & Ginning Co. v. West Bros., 82 Okla. 145, 198 Pac. 855 (1921). Choctaw Cotton Oil Co. v. Corporation Commission of Okla., 121 Okla. 51, 247 Pac. 390 (1926) held constitutional the specific statute discussed in the Frost case, *infra* note 8.

[8] 278 U. S. 515, 49 Sup. Ct. 235 (1929).

[9] OKLA. COMP. STAT. (1921) § 3713 (as amended by Okla. Laws 1923, c. 191, p. 340) had provided that no person or corporation should be permitted to operate a gin without first having secured a license from the State Corporation Commission. The Act of 1925, which was held unconstitutional, declared: "No new gin plants shall be constructed, installed or licensed, or any old gin removed from one point to another until satisfactory showing shall have been made to the Corporation Commission setting forth

atives, whether of the stock or nonstock type.[10] Between a stock cooperative and an ordinary commercial corporation, Mr. Justice Sutherland held, there was no distinction sufficient to warrant separate classification. Accordingly, the plaintiff had been denied the equal protection of the law because the defendant, a cooperative of the "stock" type, had not been required to show a public need for his gin before a license was granted him.[11] The decision of the Court did not question the propriety of treating cooperative associations and ordinary business enterprises as two distinct types of organization for regulative purposes. The Court's objection went to the form of the cooperative rather than to the end it seeks to attain, for nonstock associations were considered susceptible of separate classification.[12]

Reorganization of all cooperative associations on a nonstock basis was the obvious method of avoiding the limitation imposed by the decision. But since by far the greater majority of cooperatives in Oklahoma were, and still are, of the stock type,

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that such gin is a needed utility, and that the proposed corporation, company, firm or individual is a competent and desirable corporation, company, firm or individual to establish and operate said gin as may appear in the discretion of said Commission; provided, that on the presentation of a petition for the establishment of a gin to be run co-operatively, signed by one hundred (100) citizens and taxpayers of the community where the gin is to be located, the Corporation Commission shall issue a license for said gin." OKLA. COMP. STAT. (1921) § 3714 (as amended by Okla. Laws 1925, c. 109, § 1).

[10] The defendant cooperative was organized under the 1919 act, *supra* note 4.

[11] A discussion of the decision is not in order here. The dissents of Mr. Justice Brandeis and of Mr. Justice Stone, in both of which Mr. Justice Holmes concurred, set forth the contrary view of the problem. For an exhaustive critique of the case see Hamilton, *Judicial Tolerance of Farmers' Cooperatives* (1929) 38 YALE L. J. 936.

[12] This division of cooperatives into two groups finds no support in the past history of the cooperative movement. The "rules" set out by the Grange Convention of 1875, the first guide to the formation of cooperatives in this country, provided for the organization of these units on a stock basis. NOURSE, *op. cit. supra* note 1, at 35-6. Today, at least thirty-three states provide for the formation of such organizations. See the dissent of Mr. Justice Brandeis in the Frost case, *supra* note 8, at 540, 48 Sup. Ct. at 244. Congress has twice recognized the special purpose of these stock cooperatives, as well as their dissimilarity from ordinary business corporations. Revenue Act of 1926, 44 STAT. 39 (1926), 26 U. S. C. § 982 (1926) (exempting stock cooperatives from corporate income taxes); Capper-Volstead Act of 1922, 4 STAT. 388 (1922), 7 U. S. C. § 291 (1926) (removing contracts made by stock cooperatives with members and non-members from the category of contracts in restraint of trade). Not till the decision of Mr. Justice Sutherland was it suggested that these organizations were indistinguishable from commercial corporations. His logic seems unreal and legalistic rather than practical.

it was deemed expedient to experiment further with legislation before discarding the existing form of cooperative organization.[13] A statute was therefore passed in 1929 divesting of the "public interest" those gins which accepted business solely from those maintaining and operating the gin.[14] Gins were thereby divided into two groups: the cooperative gins, now operating as private enterprises, and the commercial gins, operating as public businesses. In this strange blending of competition and monopoly was sought freedom for the cooperative.

The experiment was short-lived. The statute was declared unconstitutional in *Chickasha Cotton Oil Co. v. Cotton County Gin Co.*,[15] a decision which is also important because it sustained the previously assumed power of the Oklahoma legislature to affect ginning with the public interest.[16] In the *Chickasha* case, the plaintiff, a duly licensed ginner, sought to enjoin the defendant from setting up a gin under the 1929 Act. The defendant had brought himself within the letter of this Act by subscribing for 24,850 shares of his own capital stock, of a nominal value of one dollar a share, and selling the remaining 150 shares to his prospective customers, the cotton growers in his vicinity. By the terms of the Act the defendant then incorpo-

[13] At the time of the decision in the Frost case, 82% of the cooperatives in Oklahoma were of the stock type. See the dissent of Mr. Justice Brandeis, 278 U. S. at 548, 49 Sup. Ct. at 247, for detailed statistics of the set-up in the state at that time.

At least one writer maintains the position that the ends attained through the stock cooperative may be attained through the nonstock type. See Hamilton, *op. cit. supra* note 11, at 953. Mr. Justice Brandeis, however, suggests that the history of the movement demonstrated the need for organizations of the stock type. 278 U. S. at 547, 49 Sup. Ct. at 246. Mr. Justice Brandeis' reasoning is not altogether convincing. It seems plausible that ingenious manipulation and modification of the nonstock form of organization might well have produced the results attained by the use of the stock type. It is true at least that the adoption of this latter type was the simpler and more obvious procedure.

[14] Okla. Laws 1929, c. 240, amending OKLA. COMP. STAT. (1921) § 3712 to read as follows: "That cotton gins maintained and operated for the purpose of ginning seed cotton of the general public, or of persons other than the person or persons, or the stockholders of the corporation maintaining and operating said gin, or maintained and operated for the purpose of ginning seed cotton not produced and owned by the person or persons, or the stockholders of the corporation, maintaining and operating said gin, are hereby declared to be public utilities, and the operation of same for the purpose of ginning seed cotton is declared to be a public business."

[15] 40 F. (2d) 846 (C. C. A. 10th, 1930). An earlier case attacking the constitutionality of this statute, Owens v. Corporation Commission of Oklahoma, 41 F. (2d) 799 (W. D. Okla. 1930), was dismissed on the ground that the plaintiff was not in a position to challenge the statute.

[16] The court in the Owens case, *supra* note 15, remarked: "For the general public good, the question ought to be settled one way or another, which can only be done by the Supreme Court of the United States." 41 F. (2d) at 803.

rated, not as a regulated public utility, but as an independent unlicensed ginner. Pointing to the abuse of the statute, the plaintiff claimed that the Act violated the due process and equal protection clauses of the Fourteenth Amendment. The defendant contended in his answer that as the earlier law declaring gins public utilities was unconstitutional he needed no license to operate; but that if it were constitutional, the 1929 Act, excusing ginners of his type from the requirement of obtaining a license, was also constitutional. The District Court decided in favor of both of the defendant's contentions, and dismissed the bill. The Circuit Court reversed this decision on both counts. The conditions existing in the ginning industry, the long acquiescence in the validity of the early law by ginners and growers alike, and the assumption of the validity of the law by the Supreme Court in the *Frost* case led this tribunal to declare the affectation valid.[17] The 1929 Act, however, open as it was to abuse, and open also to the objection made in the *Frost* case to the 1925 statute, namely, that it failed to distinguish between true cooperative associations and stock corporations, the Circuit Court held invalid as discriminatory. The Court indicated that, had the Statute applied solely to genuine cooperatives as defined by the *Frost* case, there would have been no discrimination.[18]

This judicial erasure of the 1929 Act reestablished the *Frost* case as the basis upon which the cooperatives must build.[19]

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[17] Each of the three judges sitting on the case wrote a separate opinion. Two of them discussed gravely whether or not the cotton ginning industry falls within the three classes of public utilities set out by Mr. Chief Justice Taft in Wolff Packing Co. v. Court of Industrial Relations, 262 U. S. 522, 43 Sup. Ct. 630 (1923). Both decided in the affirmative. The third judge, showing more of a consciousness that the court was dealing with an economic rather than a legal problem, stressed the conditions prevailing in the industry before the passage of the 1915 statute.

[18] "I thought then, and think now, that the Legislature has power to classify genuine co-operative associations or corporations; one who gins his own cotton, or a group of growers who incorporate for the purpose of ginning their cotton, may be fairly and differently classified from those who gin cotton primarily for profit. But the 1929 amendment is not so drawn as to confine the exemption to cooperative enterprises. There are no real limitations in it. The defendant is not a co-operative concern at all; it is a commercial enterprise; on its present plan, when working to capacity, $24,850 of its $25,000 capital will be owned by a commercial ginner, who grows cotton as a side line, or to enable him to gain exemption from the regulation to which other commercial ginners are subject. It is 6/10 of 1 per cent. co-operative, and that is not enough. Because it is not in fact and truth a co-operative concern, and because the amendment permits of such a subterfuge, and for that reason alone, I agree the amendment cannot stand." McDermott, J., 40 F. (2d) at 852.

[19] The possibility that the Chickasha case may be reversed by the Supreme Court must not be overlooked. There seems little chance, however, that this possibility will be actualized. The nature of the ginning industry

However, a few weeks after the *Chickasha* case was decided, the Supreme Court handed down the decision of *Corporation Commission of Oklahoma v. Lowe*[20] which raises grave doubts as to the effect of the *Frost* case. Though decided after *Chickasha v. Cotton County Gin Co.*, the *Lowe* case began its course through the courts before the passage of the Act held unconstitutional in the *Chickasha* decision. This latter decision and the 1929 Act are therefore no part of its setting. The fact patterns of the *Lowe* and the *Frost* cases are much alike. In each the plaintiff, a licensed ginner, sued to enjoin the licensing of a cooperative gin. But the plaintiff in the *Lowe* case claimed that the statute permitting cooperatives to distribute earnings to customers as "patronage dividends" based on the business brought to the gin by the customer[21] discriminated against non-cooperative ginners who were required to conform to the rate schedule set by the Commission and were denied the right to give rebates. The injunction was granted by a three judge court. In reversing this decision, Mr. Chief Justice Hughes, speaking for a unanimous court, declared that the plaintiff had failed to show any law of Oklahoma or ruling of the Commission forbidding the plaintiff to distribute his own earnings to his customers, and therefore that any claim of discrimination was unfounded.

The *Lowe* case is of more interest for what it does not say than for what it does. The court hurdled completely at least one issue which might have proved embarrassing. This was whether the cooperative had made a satisfactory showing of public neces-

makes a strong case for upholding the affectation statute. The freshness of the Frost case in the mind of the Court makes it unlikely that the 1929 Act would be held constitutional. Of course the Court might very well hold the statute itself constitutional as a valid classification, and find that this particular plaintiff was not within the classification there set out.

[20] 281 U. S. 431, 50 Sup. Ct. 397 (1930).

[21] OKLA. COMP. STAT. (1921) § 5648. The pertinent parts of the statute read as follows: "The directors, subject to revision by the stockholders, at any general or special meeting lawfully called, shall apportion the net earnings and profits thereof from time to time at least once in each year in the following manner:

(1) Not less than ten per cent thereof accruing since the last apportionment shall be set aside in a surplus or reserve fund until such fund shall equal at least fifty per cent of the paid-up capital stock.

(2) Dividends at a rate not to exceed eight per cent per annum, may, in the discretion of the directors, be declared upon the paid-up capital stock. Five per cent may be set aside for educational purposes.

(3) The remainder of such net earnings and profits shall be apportioned and paid to its members ratably upon the amounts of products sold to the corporation by its members, and the amounts of the purchases of members from the corporation provided, that if the by-laws of the corporation shall so provide, the directors may apportion such earnings and profits in part to non-members upon the amounts of their purchases and sales from or to the corporation."

sity when it applied for its license. Nothing stood out more clearly from the *Frost* case than that this was a universal standard to be met by every ginner seeking to set up a gin.[22] Since there is no mention, either in the briefs or in the opinion of the *Lowe* case, of compliance or non-compliance with this requirement by the cooperative, it would be supposed that the Commission had made an exhaustive inquiry into the circumstances surrounding the defendant's application for a license. Yet the record, far from showing that this requirement had been met, rather discloses that the plaintiff was given no opportunity to argue before the Commission his claim that there was no public need for his competitor's gin; nor does the record disclose what showing of public need was in fact made by the defendant.[23] Whether the procedure before the Commission justified the assumption that a sufficient showing of necessity had been made, seems at least debatable. The failure of counsel to raise the questions of adjective law involved is inexplicable. Certainly this neglect afforded the Supreme Court an opportunity to overlook, consciously or unconsciously, an issue common to both the *Frost* and the *Lowe* cases. The raising of this issue of public necessity might well have resulted in a contrary decision of the latter case. Thus while the result reached in the case is to be applauded, its silence leaves unsettled an important question. It is still the law of Oklahoma that a showing of public necessity is a condition precedent to the securing of a ginning license. Thus far none of the cases has indicated of what such a showing must consist. The Court in the *Lowe* case left undisturbed the finding of the Commission on that point. It is true that the issue was raised only indirectly, but if the case may nevertheless be interpreted as representing the view that the issuing of licenses is to be at the discretion of the Commission, the problem becomes

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[22] The Frost case literally did no more than hold invalid a particular statute providing for obtaining licenses by another means than that of showing public necessity. Its implications nevertheless would seem broad enough to cover other cases where the resulting discrimination would be the same as under the statute of the Frost case, whether this discrimination resulted from procedural or other faults of the Commission.

[23] On March 8, 1929, the cooperative filed with the Corporation Commission an application for a license to gin. A hearing on the application was set for March 18 and held on that date, the Commission taking the application under advisement. Lowe, who owned two gins which would be in competition with the new gin, first heard of the application and the hearing after the latter had been held. He at once filed an application to reopen the case, claiming that there was no need for the defendant's proposed gin. On April 8 the Commission rejected this application for a rehearing. Record on Appeal, pp. 6-7. On the following day the plaintiff filed with the District Court his bill for an injunction. The record unfortunately contains no copy of any of the orders or findings of the Commission.

administrative rather than judicial. Free from fear of reversal by the courts, the Commission may then face with frankness economic considerations;[24] legal doctrines will no longer be the medium in which the final decision is rendered. Such a procedure affords an enviable short-cut to the realization of a social program by eliminating the possibility that the shift in terms from economic policy to legal doctrine will result in the disposal of a case on irrelevant legalistic issues.

The Court's treatment of what it apparently conceived to be the sole issue in the case is not so happy. It should first be noted that cotton ginning is by statute a public business subject to the control of the Commission. One of the chief incidents to the regulation of a public business is the maintenance of a uniform rate schedule. This requires not only that charges for service be no more than those set, but also that they be uniform, lest discrimination ensue.[25] Past experience has shown that the giving of rebates is a ready means of enabling a utility or a carrier to deviate from a rate schedule.[26] The instant decision frankly legitimizes this practice, for, however dignified their title, "patronage dividends" smack of rebates. With no check on the uniformity of service charges it will be an ingenious Commission indeed that can devise effective means of controlling the industry.[27]

Furthermore, in considering the effect of the holding in the *Lowe* case upon the cotton ginning industry, attention is at once

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[24] It may be argued that the intention of the Court would in no case be to deprive the courts of all power of review. To do so would probably be unconstitutional as a violation of the due process clause. See Ohio Valley Water Co. v. Ben Avon Borough, 253 U. S. 287, 40 Sup. Ct. 527 (1920). The scope of this limited review is a matter of speculation. An analogous situation has arisen from the passage of statutes in some states making a showing of "public convenience and necessity" a condition precedent to receiving a license permitting the operation of motor busses. For a discussion of the problems arising in connection with these statutes see Lilienthal and Rosenbaum, *Motor Carrier Regulation by Certificates of Necessity and Convenience* (1926) 36 YALE L. J. 163 (particularly, in regard to judicial review, at 190-192).

[25] See Messenger v. Pennsylvania Ry., 37 N. J. L. 531 (1874); Pennsylvania Ry. v. International Coal Mining Co., 230 U. S. 184, 33 Sup. Ct. 893 (1913); Wight v. United States, 167 U. S. 512, 17 Sup. Ct. 822 (1897). See also NICHOLS, PUBLIC UTILITY SERVICE AND DISCRIMINATION (1928) 880-881, and cases there cited.

[26] *Supra* note 25. Here again the brief for Lowe seems inadequate. It includes no presentation of the economic situation, nor of past experience in the giving of rebates in other fields of governmental regulation.

[27] State regulation does not always bring with it the consequences desired. New State Ice Co. v. Liebmann, 42 F. (2d) 913 (W. D. Okla. 1930), is an interesting illustration of how the affectation of the ice industry with the public interest resulted in more evil than good. A competitive industry became a monopoly in the hands of a few large entrepreneurs. The court in consequence held the statute unconstitutional.

attracted by the differences in the two types of organization engaged therein. On the one hand is the commercial enterprise operating for private gain; on the other, the cooperative seeking to provide service at cost. The statutes of Oklahoma clearly contemplate that the ginning industry is to be open to all comers, whether individual, corporate or cooperative. But since cooperatives may distribute patronage dividends, and are allowed by statute to gin for non-members, commercial ginners must either declare such dividends or see their customers disappear. The inevitable result will be the gradual elimination of private enterprise from the ginning industry. The court in the *Lowe* case gives no indication that it is aware of this problem when it justifies the right of the cooperative to distribute patronage dividends by the right of the individual to do likewise. The decision gives cooperatives extraordinary advantages over commercial gins. In view of the growth of cooperatives as a means of insuring the farmer a fair share of the ultimate selling price of his product, such a result may well be approved. But the result has been attained in such a manner as to open the decision to serious attack. Acquisitive and non-acquisitive enterprises are to compete on the same level, and "public utility" rates are to be set by this unequal competition. The artificiality of such a scheme is only too apparent.

To estimate the effect of the *Lowe* case upon the cooperative movement is a difficult task. The categories set up by Mr. Justice Sutherland have unfortunately not been directly repudiated. It is apparent that the give and take of judicial phrase-fighting must continue for some time to come before the exact forms that cooperatives may take and the powers that they may exercise will finally be defined. Even here the *Lowe* case makes little progress.[28] The case may, it is true, be considered indicative of a more benevolent attitude on the part of the Supreme Court toward cooperatives. But courts in general have accorded cooperatives judicial recognition for many years.[29] Insofar as it indicates a willingness to leave such problems to administrative bodies, such as the State Corporation Commissions, the decision is to be applauded. Such a solution will remove issues irrelevant to the real problem at stake. But the chapter of legislative and judicial history outlined above is particularly interesting for the paradox it presents. When a statute regulating an in-

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[28] See *infra* note 29. See also the dissent of Mr. Justice Brandeis in the Frost case, 278 U. S. at 540, 49 Sup. Ct. at 244. The Frost and the Lowe cases are but the first of a series in which these questions will be discussed.

[29] The early cases establishing judicial recognition are listed and discussed in NOURSE, *op. cit. supra* note 1, at 399-402; Sapiro, *The Law of Cooperative Marketing Associations* (1926) 15 KY. L. J. 1; Tobriner, *The Constitutionality of Cooperative Marketing Statutes* (1928) 17 CAL. L. REV. 19.

dustry reacts to the disadvantage of those for whose benefit it was passed, when the restrictions placed on formerly independent actors become privileges, then the law contains anomalies indeed.

CONSTITUTIONAL RESTRAINTS ON STATE FREEDOM OF ACTION IN CONFLICT OF LAWS CASES

THE recent case of *Home Insurance Co. v. Dick*[1] has again demonstrated how state freedom of action in conflict of laws situations is circumscribed by the Federal Constitution. The courts of an independent nation, when deciding a conflict of laws case, may be said either to enforce rights vested in a foreign territory, if such enforcement is not contrary to the public policy of the forum,[2] or, by another view, to create rights in the forum when in the light of its own established policy it feels free to do so.[3] Both of these theories, devised to describe judicial action in conflict of laws situations, indicate that in the last analysis the local public policy of the forum will determine whether, on the one hand, foreign rights will be enforced or, on the other, local rights created. The individual state courts of a federated nation, however, find that their own local policies must frequently give way to broader national interests.[4] The full faith and credit, the due process, the contract and the commerce clauses of the United States Constitution all confer upon the Supreme Court a general power of compelling a recognition of national interests. And more particularly, the Supreme Court, through these clauses, would seem to possess the power of compelling such a recognition of national interests by imposing its own conflict of laws views on the states so as to bring uniformity into the confused field of interstate law.[5] Although it is impossible to define the exact

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[1] 50 Sup. Ct. 338 (1930).

[2] This is the "vested rights" or "territorial" theory. Beale, *Summary of the Conflict of Laws*, 3 CASES ON THE CONFLICT OF LAWS (1902) §§ 1-5, 41, 47. Rights once vested under the law of one territory "continue until destroyed or cut off by law . . . and are recognized and enforced in one state though they have come into being in another, unless such enforcement is, for good reason, thought contrary to the public policy of the jurisdiction where enforcement is sought." GOODRICH, HANDBOOK ON THE CONFLICT OF LAWS (1927) 10. For discussion see Beach, *Uniform Interstate Enforcement of Vested Rights* (1918) 27 YALE L. J. 656; Lorenzen, *Territoriality, Public Policy and the Conflict of Laws* (1924) 33 YALE L. J. 736; Yntema, *The Hornbook Method and the Conflict of Laws* (1928) 37 YALE L. J. 468.

[3] This is the "local law" theory. Cook, *The Logical and Legal Bases of the Conflict of Laws* (1924) 33 YALE L. J. 457.

[4] DODD, STATE GOVERNMENT (2d ed. 1928) 34.

[5] See Dodd, *The Power of the Supreme Court to Review State Decisions in the Field of the Conflict of Laws* (1926) 39 HARV. L. REV. 533.

scope of this power and difficult to predict just how far the Supreme Court will go in exercising it, some idea can be given of its possible extent and of the present policy of the Supreme Court with regard to its use.

The general scope of this power can probably best be ascertained by an examination of the interpretation given the full faith and credit clause.[6] It is now well settled by Congressional enactment[7] and Supreme Court decision[8] that the judgments

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[6] From the point of view of securing Supreme Court review, either by appeal as of right or review at the discretion of the Court by writ of *certiorari*, it makes little difference whether the full faith and credit or some other clause is invoked. Appeal as of right can now be had "where is drawn in question the validity of a treaty or statute of the United States, and the decision is against its validity; or where is drawn in question the validity of a statute of any State, on the ground of its being repugnant to the Constitution, treaties, or laws of the United States and the decision is in favor of its validity." In other situations review can be had only at the discretion of the Supreme Court by bringing a writ of *certiorari*. 43 STAT. 937 (1925), 28 U. S. C. § 344 (1926). In the case where a state court applies a local statute to a foreign transaction over the objection that the statute, so applied, is unconstitutional, the due process clause would in all probability be the one invoked. But an appeal as of right could also be secured by invoking the full faith and credit clause, since by applying the local statute the forum would be rejecting the application of some foreign law, whether a statutory or decisional doctrine, or a judgment. *Cf.* Aetna Life Ins. Co. v. Dunken, 266 U. S. 389, 45 Sup. Ct. 129 (1924); Western Union v. Brown, 234 U. S. 542, 34 Sup. Ct. 955 (1914) (where interstate commerce clause invoked); New York Life Ins. Co. v. Dodge, 246 U. S. 357, 38 Sup. Ct. 337 (1918) (where contract clause involved). Under the old rules of Supreme Court review counsel were perhaps more cautious as to which clause they invoked, because by improvidently claiming an appeal as of right under one clause, they would be precluded from seeking review in the alternative on writ of *certiorari* under another clause, the two forms of review being mutually exclusive. This hazard has now, however, been removed. 43 STAT. 937 (1925), 28 U. S. C. § 344 (1926). In any case now the Court will at least consider the appeal and if a federal question is involved will review the case on its merits without quibbling over the terminology of any one particular clause.

[7] 1 STAT. 122 (1790), 2 STAT. 299 (1804). The first act provided for the authentication of foreign statutes, records and judicial proceedings and concluded by saying "the said records and judicial proceedings . . . shall have such faith and credit given to them in every court within the United States, as they have by law or usage in the courts of the state from whence such records are or shall be taken." This was supplemented by the Act of 1804 providing for the authentication of "all records and exemplifications of office books . . . not appertaining to a court" and concluded with the same mandate as to full faith and credit. The second section of this Act extended the first section and the Act of 1790 to cover territories. In the revision of 1874 these two acts became §§ 905 and 906, now 28 U. S. C. §§ 687 and 688 (1926).

[8] Armstrong v. Carson, 2 Dallas 302 (U. S. 1794); Mills v. Duryee, 7 Cranch 481 (U. S. 1813); Hampton v. McConnel, 3 Wheat. 234 (U. S. 1818). The same rule applies to Federal Court judgments and pro-

and judicial proceedings of one state must be accorded the same full faith and credit by the courts of a sister state as they would receive in the state of origin. But the Supreme Court has never expressly decided whether the full faith and credit clause also requires that one state accord a similar recognition to the statutes and decisional doctrine of a sister state. There appears to be a definite possibility that the clause does extend thus far.[9] Certainly there is no decision holding that statutes need not be given full faith and credit.[10] And although Congress has legislated only on the effect to be accorded judgments and judicial proceedings without making mention of "public acts,"[11] it is clear historically that the words "public acts" appearing in the clause were originally intended to include legislative enactments.[12]

ceedings. Supreme Lodge v. Meyer, 265 U. S. 30, 44 Sup. Ct. 432 (1924). The clause likewise extends to attachment and insolvency proceedings. Green v. Van Buskirk, 5 Wall. 307 (U. S. 1866), 7 Wall. 139 (U. S. 1868) (attachment proceedings); Harris v. Balk, 198 U. S. 215, 25 Sup. Ct. 625 (1905) (same); Crapo v. Kelly, 16 Wall. 610 (U. S. 1872) (insolvency). State courts, however, are not required to levy execution on or enforce attachment proceedings on foreign judgments. McElmoyle v. Cohen, 13 Pet. 312 (U. S. 1839). Full faith and credit need not be given to foreign judgments where the court rendering them had no jurisdiction over the parties or subject matter. D'Arcy v. Ketchum, 11 How. 165 (U. S. 1850) (defendant not duly served with process); Thompson v. Whitman, 85 U. S. 457 (1873); Pennoyer v. Neff, 95 U. S. 714 (1877); Reynolds v. Stockton, 140 U. S. 254, 11 Sup. Ct. 773 (1891) (judgment not responsive to the issues); National Exchange Bank v. Wiley, 195 U. S. 257, 25 Sup. Ct. 70 (1904) (confession of judgment by one who had no authority to do so); Baker v. Baker, Eccles & Co., 242 U. S. 394, 37 Sup. Ct. 152 (1917); Comment (1919) 28 YALE L. J. 579. And judgments penal in their nature need not be given full faith and credit elsewhere. Wisconsin v. Pelican Insurance Co., 127 U. S. 265, 8 Sup. Ct. 1370 (1888); Huntington v. Attrill, 146 U. S. 657, 13 Sup. Ct. 224 (1892).

[9] For discussion as to what is meant in the clause by "public acts" and whether this includes statutes and decisional doctrine, see Dodd, *op. cit. supra* note 5; Field, *Judicial Notice of Public Acts Under the Full Faith and Credit Clause* (1928) 12 MINN. L. REV. 439; Langmaid, *The Full Faith and Credit Required for Public Acts* (1929) 24 ILL. L. REV. 383; Schofield, Comment (1918) 13 ILL. L. REV. 43.

[10] An early state case holds that the clause does refer to statutes but that state courts are privileged on the basis of comity to refuse to entertain actions thereunder. Crippen v. Laighton, 69 N. H. 540, 44 Atl. 538 (1899).

[11] It has been argued that the Act of 1804, *supra* note 7, refers to statutes in the words "exemplifications of office books not appertaining to a court." See Atchison, Topeka & Sante Fe Ry. v. Sowers, 213 U. S. 55, 64, 29 Sup. Ct. 397, 399 (1909). It has also been pointed out that the last sentence in the Act of 1790 added nothing to the clause itself and that although provision is made for legislation, the clause is in effect self-executing. Langmaid, *op. cit. supra* note 9, at 389.

[12] As originally drafted by the Committee on Detail of the Constitutional Convention the full faith and credit clause specifically included "acts of the legislatures." 2 FARRAND, RECORDS OF THE FEDERAL CONVENTION (1911) 188. The Committee on Style changed this to "Public Acts." *Ibid.* 577.

Moreover certain decisions of the Supreme Court declaring the clause inapplicable to particular types or particular provisions of statutes have indicated *sub silentio* that the clause does refer to statutes in general and is self-executing.[13] It has been argued that decisional doctrine is also included within the scope of the full faith and credit clause[14] and certain cases seem to indicate that the clause covers both foreign statutes and such doctrine.[15]

For the early history of the clause see Costigan, *The History of the Adoption of Section I of Article IV of the United States Constitution* (1904) 4 COL. L. REV. 470; Cook, *The Powers of Congress Under the Full Faith and Credit Clause* (1919) 28 YALE L. J. 421 (suggesting additional legislation).

[13] State courts are not required to give full faith and credit to provisions in foreign wrongful death statutes restricting venue to the courts of the state in which the statute was enacted. Atchison, Topeka & Santa Fe Ry. v. Sowers, *supra* note 11; Tennessee Coal, Iron & R. R. Co. v. George, 233 U. S. 354, 34 Sup. Ct. 587 (1914). Since in the Sowers case the petition for review was grounded on an alleged violation of the full faith and credit clause in refusing to follow the foreign restrictive provision, it has been argued that the Supreme Court in granting the review admitted that an alleged denial of full faith and credit to a foreign statute raised a federal question and that the case accordingly stands for the proposition that the clause does extend to statutes and is self-executing. Langmaid, *op. cit. supra* note 9, at 390. Likewise the rule that a mere misconstruction or misapplication of a foreign statute does not raise a federal question might well be regarded as an exception to the more general rule that statutes must be given full faith and credit. *Cf.* Chicago and Alton R.R. v. Wiggins Ferry Co., 119 U. S. 615, 7 Sup. Ct. 298 (1887); Banholzer v. New York Life Insurance Co., 178 U. S. 402, 20 Sup. Ct. 972 (1900); Eastern Building & Loan Ass'n v. Williamson, 189 U. S. 122, 23 Sup. Ct. 527 (1903); Western Life Insurance Co. v. Rupp, 235 U. S. 261, 35 Sup. Ct. 37 (1914); Kryger v. Wilson, 242 U. S. 171, 37 Sup. Ct. 34 (1916); Pennsylvania Insurance Co. v. Gold Issue Co., 243 U. S. 93, 37 Sup. Ct. 344 (1917). The same view may be taken with respect to the rule that the decision of the forum is final in construing foreign statutes in the light of foreign constitutions. *Cf.* Smithsonian Institute v. St. John, 214 U. S. 19, 29 Sup. Ct. 601 (1908).

[14] Schofield, *op. cit. supra* note 9, at 56.

[15] This is particularly true in certain fraternal benefit association and insurance cases. Royal Arcanum v. Green, 237 U. S. 531, 35 Sup. Ct. 724 (1915); Hartford Life Insurance Co. v. Barber, 245 U. S. 146, 38 Sup. Ct. 54 (1917); Modern Woodman v. Mixer, 267 U. S. 544, 45 Sup. Ct. 389 (1925). These decisions are discussed *infra.* That these cases may be considered in a class by themselves does not detract from the scope of the clause, but only indicates the limited exercise by the Supreme Court of the power conferred. *Cf.* Pennsylvania R.R. v. Hughes, 191 U. S. 477, 24 Sup. Ct. 132 (1903), *infra* note 17. The most definite statement on the subject is contained in a recent Connecticut case. Commonwealth Fuel Co. v. McNeil, 103 Conn. 390, 130 Atl. 794 (1925). Here an action was brought for damages in Connecticut grounded on fraud perpetrated in New York. No statute, but only New York common law doctrine, was involved. The court gave relief saying: "Such an obligation, or right of action, as a general rule, becomes vested, and will be enforced here precisely as if the obligation or right of action had accrued or arisen in this jurisdiction. The full

If the full faith and credit clause requires recognition by the states of the judgments, judicial proceedings, statutes and decisional doctrine of sister states, the Supreme Court would seem to possess the power to dictate to the states the rules of the conflict of laws for them to follow. Yet even conceding this broad power, it is nevertheless quite unlikely that the Supreme Court at the present time will make full use of it. Aside from compelling states to accord full faith and credit to sister state judgments and judicial proceedings, irrespective of the local policy of the forum,[16] the Court has in no uncertain terms declared that it will not interfere where a state court has merely misconstrued or misapplied a sister state's statute or decisional law.[17] Thus in *Kryger v. Wilson* [18] the Supreme Court held that a failure by a state court to apply the statute of another state raised simply

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faith and credit clause of the Constitution requires this." 103 Conn. at 406, 130 Atl. at 800.

The only ground for drawing a distinction between foreign statutory and foreign decisional law might be to leave state courts some degree of discretion in applying their own public policy where opposed to foreign "law." This objection is overcome by the liberal attitude of the Supreme Court with respect to state conflicts decisions, an attitude which may be characterized as a general policy of "hands off."

[16] Fauntleroy v. Lum, 210 U. S. 230, 28 Sup. Ct. 641 (1908) (action in Mississippi to enforce Missouri judgment on wagering contract invalid by laws of Mississippi where it was made); Roche v. McDonald, 275 U. S. 449, 48 Sup. Ct. 142 (1928) (suit in Washington on judgment obtained in Oregon on judgment debt previously barred in Washington by the Statute of Limitations). In both cases it might be argued that the foreign judgments to which credit was required to be given violated due process since they enforced liabilities that had no existence where they were said to arise. *Cf.* Home Insurance Co. v. Dick, *supra* note 1. These cases make judgment recognition practically mandatory where the courts of sister states had jurisdiction. Kenney v. Supreme Lodge, 252 U. S. 411, 40 Sup. Ct. 371 (1920) (overruling Dougherty v. American McKenna Process Co., 255 Ill. 369, 99 N. E. 619 (1912)); Marin v. Augedahl, 247 U. S. 142, 38 Sup. Ct. 452 (1917); Comment (1918) 28 YALE L. J. 264.

[17] See cases cited *supra* note 13. It has also been held that misapplication of the local common law of Pennsylvania by a Pennsylvania court instead of the common law as interpreted in New York in the determination of the validity of a stipulation exempting a carrier from liability raised no federal question. Pennsylvania R.R. v. Hughes, *supra* note 15.

A recent California case, where the court, on the ground of public policy, refused to entertain an action based on a liability arising under an Hawaiian statute, assumes that state courts still have the constitutional privilege to reject foreign statutory actions repugnant to local policy. Hudson v. Von Hamm, 85 Cal. App. 323, 259 Pac. 374 (1927). See Day, J., in Atchison, Topeka & Santa Fe Ry. v. Sowers, *supra* note 11, at 67, 29 Sup. Ct. at 402: "It is then the settled law of this court that in such statutory actions the law of the place is to govern in enforcing the right in another jurisdiction, but such actions may be sustained in other jurisdictions when not inconsistent with any local policy of the state where the suit is brought."

[18] 242 U. S. 171, 37 Sup. Ct. 34 (1916) See Comment (1927) 26 YALE L. J. 406.

a question of local common law "a matter with which this court is not concerned." In this case it appeared that a contract was made in Minnesota for the sale of land in North Dakota. The vendor gave notice of the rescission of the contract in accordance with a North Dakota statute and brought suit in North Dakota to quiet title to the land. The vendee contended that the law of the place where the contract was made should control the steps necessary for rescission and that in so far as the North Dakota court refused to apply a Minnesota statute dealing with rescission there had been a deprivation of property without due process of law. In rejecting this contention, the hands-off policy of the Supreme Court was expressed in such definite language as to make it seem unlikely that any different result would have been reached had the full faith and credit clause been invoked.[19]

In two lines of cases, however, there has been a deviation from this policy as announced in *Kryger v. Wilson.* The first group involves the liability of stockholders in a foreign corporation as fixed by its charter and the statutes and judicial decisions of the state of incorporation. *Converse v. Hamilton,*[20] the earliest case, held that, regardless of its own local policy, Wisconsin must give full faith and credit to a Minnesota statute authorizing the extra-territorial enforcement of stockholders' liability by the receiver of insolvent corporations incorporated in Minnesota.[21] While fundamentally the case is one involving recognition of the particular judicial proceedings by which the receiver was appointed, the decision of the Supreme Court hinges on the wording of the statute clothing the receiver with power to enforce liability in other states.[22] A similar result was reached in the

[19] *Ibid.* 176, 37 Sup. Ct. at 35. Other cases lend support to this contention that in matters of purely local concern the Supreme Court will not impose its own conflicts views on the state courts. Eastern Building & Loan Ass'n v. Williamson, *supra* note 13; Johnson v. New York Life Insurance Co., 187 U. S. 491, 23 Sup. Ct. 194 (1903); Allen v. Alleghany Co., 196 U. S. 458, 25 Sup. Ct. 311 (1905); Western Life Insurance Co. v. Rupp, *supra* note 13; Pennsylvania Insurance Co. v. Gold Issue Co., *supra* note 13; Bothwell v. Buckbee, Mears Co., 275 U. S. 274, 48 Sup. Ct. 124 (1927).

[20] 224 U. S. 243, 32 Sup. Ct. 415 (1912).

[21] *Cf.* Hancock National Bank v. Farnum, 176 U. S. 640, 20 Sup. Ct. 506 (1900), where the refusal of a Rhode Island Court, on the grounds of public policy, to entertain a suit by a judgment creditor of a Kansas corporation against a Rhode Island stockholder for the enforcement of liability under the laws of Kansas was held a violation of the full faith and credit clause. This being a case of judgment recognition it did not go as far as the Converse case. See Kuhn, *Extraterritorial Enforcement of Statutes Imposing Double Liability Upon Stockholders* (1908) 17 YALE L. J. 457.

[22] In an earlier case the Wisconsin court had held that the Minnesota statute did not authorize the receiver to proceed against stockholders outside of the state. The Supreme Court said this was a fair interpretation of Minnesota statutes and "law" and that in any event Wisconsin could refuse to entertain the suit on the basis of comity, its own interpretation of foreign

later case of *Marin v. Augedahl*[23] when even the possibly erroneous construction put upon this same Minnesota statute by the Minnesota courts was held binding on the courts of North Dakota.[24] And a like departure from the Supreme Court's customary policy of hands-off is also to be found in *Royal Arcanum v. Green*[25] and its successor, *Modern Woodmen v. Mixer*.[26] In both cases it was held that where a fraternal benefit society endeavors to enforce assessments on members resident in other states, such states must look to the law of the state of incorporation in deciding upon the validity of the assessments and give full faith and credit to the statutes and decisional doctrine of the incorporating state.

The second group of cases embraces controversies involving the extra-territorial application of state statutes regulating insurance. The Supreme Court held in *New York Life Insurance Co. v. Head*[27] and *New York Life Insurance Co. v. Dodge*[28] that a state cannot extend a non-forfeiture statute to a loan made wholly outside the state, though executed in accordance with

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law being conclusive. Finney v. Guy, 189 U. S. 335, 23 Sup. Ct. 558 (1902). In the Converse case there was, of course, no room for interpretation, since the statute expressly stated the receiver could sue outside the state. An ordinary receiver appointed in a federal court in one state, being merely the appointee of a court of equity, cannot sue in the federal courts in other states. Sterrett v. Second National Bank, 248 U. S. 73, 39 Sup. Ct. 27 (1918); (1930) 43 HARV. L. REV. 805. But the Court said that the particular statute in Minnesota conferred upon the receiver the status of a quasi-assignee for creditors and as such entitled him to sue anywhere. It is apparent, however, that the real problem here was to find some means for enforcing a liability from which it would be inequitable to permit foreign stockholders to escape. *Cf.* Pinney v. Nelson, 183 U. S. 144, 22 Sup. Ct. 52 (1901).

In this connection it may be noted that states can refuse to entertain an action between two foreign corporations on a foreign judgment without denying full faith and credit. The only clause that can be invoked, that guaranteeing privileges and immunities to citizens, is not available to corporations. Anglo-American Provision Co. v. Davis Provision Co., 191 U. S. 373, 24 Sup. Ct. 92 (1903). *Cf.* Kenney v. Supreme Lodge, *supra* note 16. See Langmaid, *op. cit. supra* note 9, at 416.

[23] 247 U. S. 142, 38 Sup. Ct. 452 (1917).

[24] The case involved recognition of a foreign order to sequestrate assets and to levy an assessment given to the receiver of a foreign corporation. The North Dakota court contended the statute which authorized the receiver to proceed against stockholders in other states did not apply to this particular type of corporation.

[25] *Supra* note 15.

[26] *Supra* note 15. See Comment (1916) 25 YALE L. J. 324. A similar case holds that a foreign decision upholding the validity of an assessment made by an ordinary insurance company as well as the "powers" conferred on the company by its charter, must be given full faith and credit. Hartford Life Insurance Co. v. Barber, *supra* note 15.

[27] 234 U. S. 149, 34 Sup. Ct. 879 (1914).

[28] 246 U. S. 357, 38 Sup. Ct. 337 (1918).

certain provisions in the policy made within the state, without violating the constitutional provision guaranteeing freedom of contract.[29] In the more recent case of *Aetna Life Ins. Co. v. Dunken*[30] the controversy concerned the choice of law applicable to a policy of insurance issued in Texas but made in accordance with a convertible provision in an earlier policy taken out in Tennessee. A Texas court applied an onerous Texas statute imposing a heavy penalty for failure to pay the insurance within a certain time after notice by the beneficiary. It was ruled by the Supreme Court that the failure of the Texas court to apply the law of Tennessee was a violation of the Constitution; but it is not clear from the opinion whether the Court meant to rest its decision upon the due process clause, the full faith and credit clause, or both. In the principal case of *Home Insurance Co. v. Dick*[31] a Texas court sought to apply to a fire insurance policy taken out in Mexico a Texas statute declaring invalid any agreement limiting the time within which suit could be brought on a contract to less than two years. The Supreme Court concluded that the application of the Texas statute to allow a suit within two years, despite a stipulation in the contract that any action to enforce a claim thereunder must be brought within a year after loss, was a violation of the due process clause. Although the action had been brought originally against the Mexican insurance companies, liability was imposed by garnishment proceedings upon two New York companies which had reinsured the risk, even though they had never even qualified to do business in Texas and had appeared only through attorneys appointed by the court. This extension of Texas law to reach the New York companies was held distinctly unwarranted. The Court said:

"We need not consider how far the state may go in imposing restrictions on the conduct of its own residents, and of foreign

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[29] In the latter case, and the former is on all fours with it, an insurance policy was taken out in Missouri with a New York Company. In accordance with a provision in the policy a loan was made with the company in New York. Premiums having lapsed, the paid-up value of the policy was applied to satisfy the loan as provided by a New York statute. In a suit by the beneficiary the Missouri court held such forfeiture invalid under a Missouri statute prohibiting forfeiture after three years. The decision was reversed by the Supreme Court. In a later case the policy contained an express promise by the company to loan money within the limits of the cash surrender value. A loan was later made in accordance with an application made to the company in Missouri, which was accepted by the company in New York, and a check was sent to the insured. The Supreme Court here said the contract was made in Missouri and the non-forfeiture statute applied. Mutual Life Insurance Co. v. Liebing, 259 U. S. 209, 42 Sup. Ct. 467 (1922).

[30] *Supra* note 6. See Notes (1925) 38 HARV. L. REV. 804; (1925) 20 ILL. L. REV. 72.

[31] *Supra* note 1.

corporations which have received permission to do business within its borders. . . . It may not abrogate the rights of parties beyond its borders having no relation to anything done or to be done within them." [32]

While these two groups of cases indicate that the Supreme Court has the power both to compel a state to accord full faith and credit to the statutes and decisional doctrine of sister states and to restrict a state's extra-territorial application of local statutes, they furnish no basis for the conclusion that the Supreme Court has embarked upon a general policy of bringing uniformity into state decisions on the conflict of laws.[33] *Kryger v. Wilson*,[34] has not been overruled, qualified or even regarded as requiring explanation. On the other hand, there is no indication that the Supreme Court will restrict its review of state conflicts decisions to the two groups mentioned. A further exercise of power is quite possible and perhaps, in some situations, advisable.[35]

In general it would seem that the Supreme Court will impose upon the state courts its own views of the conflict of laws only when the interests involved in a particular case are broadly national in scope. Thus where large nation-wide businesses are hampered by conflicting state rules and regulations, federal control is frequently necessary to bring about the uniformity essential to successful interstate operations. So also the security of many large corporations may be jeopardized if stockholders not residing in the state of incorporation are permitted to hide behind state barriers and escape the liability which by their contracts of membership they have agreed to assume. Likewise where assessments are made short of full liability, stockholders residing in the state of incorporation would be subjected to a greater burden in order to compensate for the immunity enjoyed by stockholders residing elsewhere. Such inequality of liability would be especially disastrous to the successful operation of a fraternal benefit society where special assessments to meet losses are so frequently

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[32] 50 Sup. Ct. at 342.

[33] Such a proposition has been advanced, however, on the strength of Aetna Insurance Co. v. Dunken, *supra* note 6. Dodd, *op. cit. supra* note 5, at 560; Note (1925) 38 HARV. L. REV. 804, 809.

[34] *Supra* note 18. This case, which was decided after Converse v. Hamilton, Royal Arcanum v. Green and New York Life Insurance Co. v. Head, mentioned none of these cases. New York Life Insurance Co. v. Dodge, Aetna Life Insurance Co. v. Dunken, Modern Woodmen v. Mixer and Home Insurance Co. v. Dick, coming later, made no reference to it.

[35] The extra-territorial use of the injunction raises an important national problem. Weaver v. Alabama Great Southern R.R., 200 Ala. 432, 76 So. 364 (1917); Union Pacific R.R. v. Rule, 155 Minn. 302, 193 N. W. 161 (1923); *cf.* Cole v. Cunningham, 133 U. S. 107, 10 Sup. Ct. 269 (1890). See Comment (1930) 39 YALE L. J. 719. Of like importance is the recognition of foreign judgments by confession. See Comment (1925) 34 YALE

made.[36] In the case of insurance companies the broad national scope of the problem is equally apparent. That the insurance business was originally of but local significance is evidenced by the case of *Paul v. Virginia*,[37] holding that such business did not constitute interstate commerce. But the subsequent nation-wide expansion of insurance has evidently led the Supreme Court to limit the regulatory powers of a state largely to transactions taking place within its borders.[38]

The distinction between conflict of laws cases involving matters of broad national interest and those involving matters of mere local concern has nowhere been expressly made by the Supreme Court. In the *Kryger* case [39] and in the later case of *Union Trust Co. v. Grosman*,[40] however, the Court did declare that it would not interfere in matters of purely local concern. From this definite expression of policy the inference may be drawn that interference is likely where the interests involved appear national in scope.[41] Yet it may be distinctly unwise for the Court to state

L. J. 886; (1924) 38 HARV. L. REV. 110. Interstate problems under the Workmen's Compensation Acts, as well as questions involving the extraterritorial effect of an automobile rental firm's liability for the injuries inflicted by the lessee, might also be clarified by federal control. See Langmaid, *op. cit. supra* note 9, at 406.

[36] It may be noted that in this first group of cases where the Supreme Court has seen fit to impose its own views of the conflict of laws, a state, by granting incorporation, acts to create rights and liabilities in a specified group of persons and their successors. The situation thus resembles the recognition of a foreign judgment or decree rather than of a general statute or general decisional law.

[37] 8 Wall. 168 (U. S. 1868).

[38] Between the one extreme where all the operative acts of a particular transaction are performed within the state of the forum and the other, illustrated in the instant case of Home Insurance Co. v. Dick, the Supreme Court has drawn an undefined line beyond which a local state court cannot go in regulating a national insurance business. The Head, Dodge and Dunken cases fall outside of the limits of a state's control. Mutual Life Insurance Co. v. Liebing, *supra* note 29, is a case falling just inside.

Compare the rule that states have no power to impose penalties on transactions taking place wholly outside their territorial limits. Allgeyer v. Louisiana, 165 U. S. 578, 17 Sup. Ct. 427 (1897); St. Louis Cotton Compress Co. v. Arkansas, 260 U. S. 346, 43 Sup. Ct. 125 (1922) (in form of tax); Compania de Tabacos v. Collector of Internal Revenue, 275 U. S. 87, 48 Sup. Ct. 100 (1927) (same).

[39] *Supra* note 18.

[40] 245 U. S. 412, 38 Sup. Ct. 147 (1918). There a married woman, domiciled in Texas, guaranteed her husband's note while she was temporarily in Illinois, where a statute gave her capacity to contract. A federal court sitting in Texas refused to allow the action on the contract on the ground of local policy and the Supreme Court held that it was under a duty so to act. Illinois law was not even considered. See also cases cited *supra* note 19.

[41] As in Western Union Telegraph Co. v. Brown, *supra* note 6. The defendant, which failed to deliver a telegram sent from South Carolina to

this affirmatively. Probably it is feared that any broad statement would result in a flood of appeals such as were predicted as an aftermath of the *Dunken* case.[42] That this case indicated no general intention to bring uniformity into state conflicts rules is evidenced by the subsequent inactivity of the Supreme Court bar. And yet the interference of the Court in that case and in others of a similar nature indicates that more is involved than a mere divergence in the views of the state and federal courts as to the correct conflict of laws rules applicable.

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the District of Columbia, was held liable for damages for mental anguish by a South Carolina court applying a local statute. The Supreme Court held that the failure to apply the common law as in force in the District of Columbia both violated the Commerce Clause and interfered with federal control in the District of Columbia. The alternative ground somewhat weakens the effect of the decision, but still it is a strong case for the proposition that the court will not allow states to impose severe burdens on interstate transactions by erroneous decisions in the conflict of laws.

[42] Note (1925) 38 HARV. L. REV. 804, 809.