Notes

THE RIGHT OF THE STATE TO DEMAND FINANCIAL RESPONSIBILITY OF AUTOMOBILE OWNERS

WHEN Massachusetts, in 1927, enacted its famous compulsory automobile insurance law,[1] the scope and novelty of the statute centered universal attention upon it as the first far-reaching attempt to deal with the problem of automobile accidents from a remedial rather than a preventive point of view.[2] The Massachusetts statute remains unique in its comprehensiveness, but recognition that the tremendous volume of motor traffic makes absolute accident prevention an impossibility has led to other legislation of a curative nature; eleven states following, but less boldly, the lead set by Massachusetts have made a more restricted effort to guarantee the financial responsibility of automobile owners by requiring, at the penalty of loss of license, that bond or insurance be provided after the award or non-payment of a judgment in a negligence suit or after conviction of a motor law offense.[3] An advisory opinion of the Massachusetts Supreme Court[4] de-

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[1] MASS. CUM. STAT. (1927) c. 90, § 34A-34-I (proof of financial responsibility, in bonds, insurance, or deposited security, up to $5000 for injury or death to one person, and $10,000 for injuries or death, resulting from one accident, made a condition precedent to the granting of automobile registration to any applicant).

[2] See Chamberlain, *Compulsory Insurance of Automobiles* (1926) 12 A. B. A. J. 49; (1927) 27 COL. L. REV. 314; (1926) 20 ILL. L. REV. 813; Snow, *Some Legal Aspects of Compulsory Automobile Insurance* (1927) 6 ORE. L. REV. 193; Heyting, *Automobiles and Compulsory Liability Insurance* (1930) 16 A. B. A. J. 362.

[3] CAL. GEN. LAWS (Deering, Supp. 1929) Act 5128, § 73 (g) (see *infra* note 7); CONN. GEN. STAT. (1930) § 1609 (proof of ability to satisfy future damage claims required from both operator and owner, after conviction of certain offenses, or accident involving personal injury or $50 property damage, in which the car was involved and the operator was partly at fault); IOWA STAT. (1929) c. 118 (automatic suspension of driver's license if accident judgment is unsatisfied after sixty days, until payment or security is furnished up to $5000 and $10,000 for personal injuries, $1000 for property damage); ME. LAWS (1929) c. 209 (security in the usual categories and amounts, as in the Iowa statute, must be furnished upon conviction of drunken or reckless driving by the operator, and may also be required of the owner; and license or registration or both may be suspended until payment of a judgment in a civil accident suit); MINN. STAT. (Mason, 1927) c. 412, §§ 2720-2761 (under penalty of license revocation, a $2500 bond conditioned for the payment of future accident judgments must be filed upon conviction of certain motor law offenses); N. D. LAWS (1929), c. 163, § 1 ($2000 bond required upon conditions similar to those in the Minnesota statute); N. H. LAWS (1927) c. 54, reenacted N. H. LAWS (1929) c. 189 (on finding of negligence in a preliminary inquiry upon petition in an action for damages, the driver's license and, if the car had been driven with the owner's consent, the registration certificate, are suspended until the judgment is paid or security given); N. J. LAWS

clared for the constitutionality of that state's inclusive law before its passage, and its validity has never since been questioned.[5] But the California Supreme Court, in the recent case of *Ex parte Lindley*,[6] branded as discriminatory and void a statute typical of the narrower method of regulation.

The California statute under review provided for revocation of the driver's license and the car's registration unless a judgment for personal injury or for property damage in excess of $100, resulting from an automobile accident, were paid within fifteen days, and bonds, insurance or other security furnished to make certain the payment of future judgments of a like nature.[7] The court, apparently viewing the statute as a punitive rather than a protective measure, seized upon the poor man's possible inability to pay damages as creating a classification founded on wealth rather than culpability, and declared the statute thus violative of the equal protection and due process clauses of the state constitution. In a concurring opinion, directed chiefly against an earlier Massachusetts declaratory judgment[8] which had upheld a proposed statute similar to that enacted in California, the seeming disregard of the remedial function of the statute was further illustrated by the argument that it could not be upheld as a preventive police measure since the penalty was not imposed for negligence and would not tend to discourage negligence.

Yet the general regulatory principle involved in this type of statute is not new. The power of the state to require bonds or insurance as a condition precedent to granting a license to engage in certain occupations connected with the public health, safety, and moral welfare has long been recognized.[9] It is, moreover, generally admitted that the state may regu-

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(1929) c. 116, § 1 (proof of financial responsibility in insurance, bonds, or security, is required upon conviction of certain offenses, or the operation of a car "concerned in" an accident involving personal injury or $100 property damage); N. Y. CONS. LAWS (Supp. 1929) c. 64 (a), §§ 94 *et seq.* (security must be furnished as in the California statute, and also for conviction of certain offenses); R. I. ACTS (1927) c. 1040, reenacted R. I. ACTS (1929) c. 1429 (security must be furnished by operators and may also be required of owners, for conviction of certain offenses, and may be imposed after a preliminary investigation, for lesser violations resulting in personal injuries or over $100 property damage); VT. LAWS (1929) No. 76, § 1 (very similar to the Connecticut statute); WIS. STAT. (1929) § 85.08 (upon recommendation of a court of record, the license is suspended after certain motor law convictions or a judgment due to the driver's negligence, unless a bond is given for payment of the judgment, or until the judgment is satisfied).

[4] In re Opinion of Justices, 251 Mass. 569, 147 N. E. 681 (1925).

[5] *Cf.* McNeil v. Powers, 165 N. E. 385 (Mass. 1929) (recovery denied under the Massachusetts Statute because driver not owner's agent, although he was a brother of the owner operating with the latter's express consent and knowledge); Note (1929) 9 B. U. L. REV. 212 (disapproving the decision as tending to nullify the effect of the law).

[6] 291 Pac. 638 (Cal. 1930).

[7] *Supra* note 3. Under the California statute the amount of security to be furnished is limited to $5000 and $10,000 for personal injuries, and $1000 for property damage.

[8] In re Opinion of Justices, 251 Mass. 617, 147 N. E. 680 (1925).

[9] Hawthorn v. Illinois, 109 Ill. 302 (1883) (statute requiring operators of butter and cheese factories on the cooperative plan to give bond held constitutional); *cf.* Kansas City ex rel. Barlow v. Robinson, 322 Mo. 1050,

late the use of its public highways by prescribing conditions deemed necessary for the public safety;[10] and upon this ground license and registration statutes,[11] and legislation of various types designed to prevent negligence,[12] to assist the injured person in obtaining his action at law,[13] or in satisfying his judgment,[14] have been sustained. Furthermore, the majority of states require owners of motor vehicles carrying passengers for hire to take out

17 S. W. (2d) 977 (1929) (city ordinance requiring bond for blasting operations upheld); Mike Beringer Moving Co. v. O'Brien, 235 Mo. App. 632, 240 S. W. 481 (1922) (city ordinance requiring bond from movers upheld). But *cf.* Gibbs. v. Tally, 133 Cal. 373, 65 Pac. 970 (1901); Valentine v. Berrien Circuit Judge, 124 Mich. 664, 83 N. W. 594 (1900); Harrigan & Reid Co. v. Burton, 224 Mich. 564, 195 N. W. 60 (1923); Merchants Mutual Auto Liability Insurance Co. v. Smart, 267 U. S. 126, 45 Sup. Ct. 320 (1925). See (1925) 25 COL. L. REV. 661.

[10] Florida v. Allen, 83 Fla. 214, 91 So. 104 (1922), 26 A. L. R. 735 (1923); Maine v. Mayo, 162 Me. 62 (1909); *cf.* Glass v. State Board of Public Roads, 44 R. I. 54, 115 Atl. 244 (1921); Buck v. Kuykendall, 267 U. S. 307, 45 Sup. Ct. 324 (1925), 38 A. L. R. 286 (1925).

[11] Rizzo v. Douglas, 121 Misc. 446, 201 N. Y. Supp. 194, (Sup. Ct. 1923); Lee v. State, 163 Ga. 239, 135 S. E. 912 (1926); Atwood v. Crowe, 110 Conn. 288, 147 Atl. 871 (1929).

[12] People v. Stryker, 124 Misc. 1, 206 N. Y. Supp. 146 (Sup. Ct. 1924) (suspension of driver's license upon arrest for driving while intoxicated); Tanguay v. State Board of Public Roads, 46 R. I. 134, 125 Atl. 293 (1924) (suspension of driver's license of anyone involved in accident resulting in death); Packard v. O'Neil, 45 Idaho 427, 262 Pac. 881 (1927), 56 A. L. R. 313 (1928) (conclusive presumption that anyone intoxicated was unable to operate a car).

[13] People v. Rosenheimer, 209 N. Y. 115, 102 N. E. 530 (1913) (penalty for leaving scene of accident); Downing v. City of New York, 219 App. Div. 444, 220 N. Y. Supp. 76 (1st Dep't 1927), *aff'd*, 157 N. E. 873 (city liable for employee's negligence); *cf.* CAL. GEN. LAWS (Deering, 1929) c. 253, §§ 62-63; MASS. ACTS (1929) c. 281; IOWA CODE (1927) §§ 5072, 5079; TEX. STAT. (1928) art. 1150; WIS. STAT. (1929) § 343.181 (statutes imposing fine or revoking license for leaving scene of accident); CONN. PUB. ACTS (1929) c. 297, § 24; VA. ACTS (1926) c. 474, § 31; WASH. COMP. STAT. (1922) § 6352 (statutes making it a duty to report accidents); N. J. LAWS (1927) c. 232; MASS. CUM. STAT. (1927) c. 90; N. Y. CONS. LAWS (Supp. 1929) (statutes providing for service upon non-residents); MICH. PUB. ACTS (1929) No. 19, § 29; CAL. STATS. (1929) c. 261; N. Y. CONS. LAWS (Supp. 1929) c. 64 (a), § 59; IOWA CODE (1927) § 5026 (statutes imputing negligence to the owner of the car where it is driven with his express or implied consent); IOWA CODE (1927) § 5026; WIS. STAT. (1929) § 85.08; CAL. GEN. LAWS (Deering, 1929) c. 253 § 23 (statutes imputing the negligence of minor to the owner, parent, or one who permits him to drive); CAL. GEN. LAWS (Deering 1929) c. 260; N. Y. CONS. LAWS (Supp. 1929) c. 27, § 282 (g); CONN. LAWS (1927) c. 209 (statutes providing for the liability of states or cities for the negligence of employees).

[14] Ex parte Maryland Motor Car Insurance Co., 117 S. C. 100, 108 S. E. 260 (1921); Mammina v. Alexander Auto Service Co., 333 Ill. 158, 104 N. E. 173 (1928), 61 A. L. R. 649 (1929) (statutes creating a lien on the car for the satisfaction of a personal judgment for damages resulting from an automobile accident). *Cf.* TENN. ANN. CODE (Supp. 1926) §§ 3079a, 197bl; S. C. CODE (1922) 5706, § 4; VA. GEN. LAWS (1923) § 2146.

liability bonds or insurance covering any judgment which may be obtained as a result of their negligent operation;[15] and although the penalty of denying registration, or license, by which this requirement is enforced, is not based upon negligence it has been upheld by the United States Supreme Court as a reasonable exercise of the state police power.[16] Statutes of the type declared unconstitutional by the California court are no more discriminatory than these and countless other examples of regulatory legislation whereby the exaction of a minimum of responsibility inevitably militates more harshly against the poorer man and could hence be said to create a classification founded upon wealth. Moreover the impending penalty of exclusion from the highways for failure to pay an accident judgment could be effectively anticipated by voluntarily taking out liability insurance before a negligent accident forces such action along with payment of the judgment claim. Recognition of the advantage of such a step might well result in giving the after-accident statutes an effect more nearly like that of the Massachusetts law.

That the state police power is not limited to preventive legislation would seem clear from the sanction accorded to the Workmen's Compensation Laws. Acceptance of the fact that industrial accidents are, to a degree, unavoidable has led to concentration upon securing an effective remedy for the injured man.[17] The statute under discussion represents a further recognition of this principle, and a limited attempt to apply it in a new, but analogous, field. In view of the amount of uncompensated damage resulting from automobile accidents,[18] and in the face of the general approbation accorded the more comprehensive Massachusetts statute,[19] it would seem not only unfortunate, but unreasonable and shortsighted to hold such an attempt unconstitutional.

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[15] ME. LAWS (1925) c. 167, §§ 7-16; N. J. LAWS (1927) c. 80; VA. GEN. LAWS (1923) § 2154 (a) 4; ILL. ANN. STAT. (1927) c. 95 (a), § 44; CONN. LAWS (1929) c. 248; N. Y. GEN. LAWS (Supp. 1929) c. 64 (a), § 17. *Cf.* Willis v. Fort Smith, 121 Ark. 606, 182 S. W. 275 (1916); State v. Bates, 30 S. W. (2d) 248 (Tenn. 1930); In re Paul Cardinal, 170 Cal. 519, 150 Pac. 348 (1915) (cases upholding municipal ordinances requiring security from various types of common carriers).

[16] Packard v. Banton, 264 U. S. 140, 44 Sup. Ct. 257 (1924). See Northern Pacific Ry. v. Schoenfeldt, 123 Wash. 579, 213 Pac. 26 (1923); Weksler v. Collins, 317 Ill. 132, 147 N. E. 797 (1925); New York v. Martin, 235 N. Y. 550, 139 N. E. 730 (1922).

[17] See New York Central R. R. v. White, 243 U. S. 188, 207, 37 Sup. Ct. 247, 254. *Cf.* Lower Vein Coal Co. v. Industrial Board of Indiana, 255 U. S. 144, 41 Sup. Ct. 252 (1921).

[18] The problem of financial irresponsibility has been accentuated in recent years by the extensive use of the installment plan purchase and of conditional sales, both of which have created a large class of automobile "owners" unable to pay money judgments. See Note (1926) 24 MICH. L. REV. 586.

[19] In re Opinion of Justices, *supra* note 4. Even under the Massachusetts statute, it is still necessary for an injured person to seek relief through the courts. Because of the difficulties of proving negligence, the technicalities and unavoidable delays of legal procedure, compulsory accident compensation administered in the manner of the Workmen's Compensation Laws has been widely advocated. See *Report of the Special Commission to Study Compulsory Motor Vehicle Liability Insurance* (1930) 15 MASS. L. Q. 7; (1926) 12 VA. L. REG. (N.S.) 33; Carman, *Is a Motor Vehicle Accident Compensation Act Advisable* (1919) 4 MINN. L. REV. 1; Marx, *Compulsory*

DELAYS IN EVICTION ACTIONS AS A MEANS OF UNEMPLOYMENT RELIEF

FROM 1919 to 1922 the Emergency Housing Law's[1] evoked a furore of protest and approbation. Now once again as a result of an "emergency"—this time a widespread business depression—the problem of state regulation of housing in time of stress has been presented to the courts. The issue has arisen from an attempt on the part of the mayor's Unemployment Relief Committee of New York City to alleviate the effects of unemployment by instructing the city marshalls to refuse to execute warrants of eviction for non-payment of rent. The recent issuance of a mandamus on application of a protesting landlord in the case of *In re Altman*[2] has nullified the Committee's action.

The declaration of an outright moratorium on rents in time of peace would be of doubtful validity, however great the public emergency. Yet restrictive legislation of housing is not novel, although the full extent of the state's regulatory power is still undetermined. During the housing shortage following the World War various remedial measures were devised and instituted.[3] Rental legislation provided a defense to an action for the recovery of more than a "reasonable rent."[4] The possessory action of summary dispossess proceedings against tenants holding over was suspended, and the right of eviction denied save for certain specified exceptions.[5] Despite immediate vociferations of "due process," "equal protection," "freedom of contract," and "impairment of the obligation of contracts" the regulatory measures were upheld.[6] Interference with the transaction of government business and the existence of a social emergency constituting a menace to health, morality, and general welfare were regarded as temporarily affecting the landlord-tenant relationship with a public interest.[7] As stated in

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Compensation Insurance (1925) 25 COL. L. REV. 164. But see Stone, *Some Views on Compulsory Automobile Insurance* (1927) 13 A. B. A. J. 151; Ives, *Compulsory Liability Insurance, with Special Reference to Automobiles* (1925) 59 AM. L. REV. 138.

[1] See *infra* notes 3 and 4. For foreign legislation and decisions see: CAIRNS, RENT RESTRICTIONS (1923); VEILLER, HOW ENGLAND IS MEETING THE HOUSING SHORTAGE (1920).

[2] 138 Misc. 745, 247 N. Y. Supp 53 (Sup. Ct. 1931).

[3] The measures employed to remedy the situation may be classified as follows: (a) Government construction. Massachusetts authorized city and town acquisition of real property to provide shelter for inhabitants. Mass. Gen. Acts 1920, c. 554; MASS. CONST. AMENDMENTS (1920) art. 47. Federal construction was likewise carried on. Great Britain undertook to build 500,000 houses under its Housing and Town Planning Act of 1919. 9 & 10 GEO. V, c. 35. (b) State and local advancement of funds. Wis. Laws 1919, c. 402; N. D. Laws 1919, c. 150; S. D. CONST. (1920) art. 13 § 17. (c) Tax exemptions. (d) Rental regulation and restriction on eviction. See Dodd and Zeiss, *Rent Regulation and Housing Problems* (1921) 7 A. B. A. J. 5.

[4] "District of Columbia Rents," 41 STAT. 298 (1920); "Housing Laws of New York," N. Y. Laws 1920, c. 130-139, 942-953; Wis. Laws 1920, c. 16, 28. Similar legislation was passed in other states.

[5] *Ibid.*

[6] Block v. Hirsh, 256 U. S. 135, 41 Sup. Ct. 458 (1921); Levy Leasing Co. v. Siegel, 258 U. S. 242, 42 Sup. Ct. 289 (1922); Marcus Brown Holding Co. v. Feldman, 256 U. S. 170, 41 Sup. Ct. 465 (1921); People ex rel. Durham Realty Corp. v. La Fetra, 230 N. Y. 429, 130 N. E. 601 (1921).

[7] Block v. Hirsh, *supra* note 6, at 155, 41 Sup. Ct. at 459.

Block v. Hirsch, "A limit in time, to tide over a passing trouble, well may justify a law that could not be upheld as a permanent change."[8] Like the Emergency Rent Laws the action of the Relief Committee was designed to have only a temporary effect.[9] But unlike the post-war measures the order in the instant case proposed to permit tenants to remain in possession without the payment of any rent, an action that approximates the commandeering of private property without compensation. An important factor in the sustainment of the Emergency Housing Laws was the express provision for a "reasonable rent."

The instant case represents municipal rather than state action. That fact should not detract from the significance of the issue presented; the imperative need for legislative action is just as apparent.[10] Other methods of accomplishing the purpose of the Committee are available. The purely statutory remedy of summary dispossess proceedings may be abolished.[11] The delay effected by the more dilatory action of eviction offers at least a short respite to the impoverished tenant. The period of required notice to move may, likewise, be extended.[12] Suspension of the right to collect rent would, however, result in a shifting of the burden upon a particular class of persons, "themselves sorely pressed in this crisis," rather than upon the community where it rightfully belongs.[13] As emphasized by the instant court, "the problem is one for the public and quasi-public agencies to solve."

THE OVERCAPITALIZATION OF PUBLIC UTILITIES THROUGH THE ISSUANCE OF STOCK TO COVER BOND DISCOUNT

THE price an investor will pay for bonds is a function of many variables, among them the rate of interest thereon, the security behind the issue and the credit of the issuer. If the rate of interest they bear equals the "market rate" of interest for investments of a comparable nature and security, they may be sold at 100 per cent of their face value. But if the rate of return is less than this hypothetical "market rate," the bonds can be sold only at a discount, in which case the issuer fails to realize from their sale the full face value of the instruments.[1] Furthermore, if the bonds have

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[8] *Ibid.* 157, 41 Sup. Ct. at 460.

[9] See *ibid.* 157, 41 Sup. Ct. at 460. The New York acts were to be effective until Nov. 1, 1922. See also Marcus Brown Holding Co. v. Feldman, *supra* note 6, at 170, 41 Sup. Ct. at 466.

[10] "The housing of the poorer classes has become a pressing problem in all populous western countries." ENCYCLOPEDIA BRITANNICA (13th ed. 1920) tit. Housing, Vol. XIII, 814, 826. "The maintenance and distribution at reasonable rates, during time of war, public exigency, emergency, or distress, of a sufficient supply of food and other common necessaries of life and the providing of shelter, are public functions. . . ." MASS. CONST. AMEND. (1920) art. 47. See also (1921) 9 CALIF. L. REV. 337, 338 n. 11.

[11] See People ex rel. Durham Real Estate Corp. v. La Fetra, *supra* note 6, at 440, 130 N. E. at 605: "The legislature might repeal or suspend in whole or in part the remedy of summary proceedings for the possession of real property." See also Dodd and Zeiss, *supra* note 3, at 10.

[12] See Dodd and Zeiss, *supra* note 3, at 12.

[13] See instant case at 747, 247 N. Y. Supp. at 55.

[1] Conversely, if the offered rate is higher than the "market rate," the bonds can be sold at a premium. For a more detailed analysis of bond prices see DEWING, THE FINANCIAL POLICY OF CORPORATIONS (1926) 513.

been marketed through investment banking houses the issuer loses an additional fraction of their face value by way of a brokerage fee.[2] The recent case of *In re Central Maine Power Company*[3] raises the question of whether these discount and brokerage costs are proper items of capitalization by a public utility.

With the permission of the Maine Public Utilities Commission the power company between 1910 and 1927 issued bonds of the face value of $19,066,500. From their sale the utility realized $17,747,475. In 1928 the unamortized discount amounted to $791,386.61, for which sum the utility had issued temporary notes. The company then sought the approval of the Commission for an issuance of common stock of an amount sufficient to take up these notes. This application was refused by the Commission on the ground that bond discount was but deferred interest, which should be paid for out of earnings rather than capitalized. The Supreme Judicial Court, agreeing with the Commission as to the nature of this discount, upheld the latter's order, stating that the statute setting out the purposes for which a utility might issue stock permitted an issuance for no such purpose as this.[4]

Accountants agree that bond discount and brokerage are items properly chargeable to operating expenses and not to capital.[5] Through a failure to apply this principle courts and commissions have all too often permitted these items to be capitalized. The question of their capitalization arises in two classes of cases, those involving valuation for rate-making and those involving petitions for approval of security issues. Of the two, the valuation cases are by far the more numerous. Prior to 1914, it was a common practice for railroads to charge these items to their construction account.[6] Today this is prohibited by the Interstate Commerce Commission.[7] State com-

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The practice of issuing bonds at a discount is often desirable because in that way the fixed charges which must be borne in the early years of a corporation's development are less than if the bonds were issued at the "market rate." The assumption is that a slightly greater redemption price works less hardship on the corporation than meeting the "market rate" of interest in its early days. See MALTBIE, THEORY AND PRACTICE OF PUBLIC UTILITY VALUATION (1924) 71.

[2] For a discussion of the advantages of marketing securities in this manner see DEWING, *op. cit. supra* note 1, at 836.

[3] 153 Atl. 187 (Me. 1931).

[4] The statute authorized the utility to issue securities, after obtaining approval of the Commission, (1) for the acquisition of property to be used in carrying out its corporate purposes; (2) for the construction, completion, extension or improvement of its facilities; (3) for the improvement or maintenance of its service; (4) for reimbursing the treasury for actual expenditures for these purposes; (5) for discharging or refunding these liabilities. ME. REV. STAT. (1930) c. 62, § 41.

[5] In brief their position is that bond discount, existing only if the bond pays less than the "market rate" of interest, is simply a postponed payment of interest that must be made at maturity of the obligation. Brokerage is an expense of procuring capital to be payed out of earnings. Both of these items should be amortized over the life of the securities, and in no event be charged to the capital account. See DEWING, *op. cit. supra* note 1, at 513; HATFIELD, ACCOUNTING (1929) 70, 229-31; 2 KESTER, ACCOUNTING, THEORY AND PRACTICE (2d ed. 1925) 364.

[6] HATFIELD, *op. cit. supra* note 5, at 230; CLEVELAND AND POWELL, RAILROAD FINANCE (1912) 334.

[7] CLASSIFICATION OF INCOME, PROFIT AND LOSS, AND GENERAL BALANCE SHEET ACCOUNTS FOR STEAM ROADS (1914) 23, 39-41; UNIFORM SYSTEM OF

missions for the most part likewise insist that these items cannot be capitalized, but must be paid out of earnings by amortization over the life of the bonds.[8] This policy, recommended in 1922 by the National Association of Railway and Utility Commissioners,[9] is supported by a majority of the court decisions[10] and by most economists.[11] On the question of whether additional bonds or stock may be issued to cover discount and brokerage costs there is less definite authority.[12] There is no uniformity in the decisions of commissions,[13] and, so far as is known, the instant case is the first decision of a court on the point.

ACCOUNTS FOR ELECTRIC RAILWAYS (1914) 59, 61, 69, 76, 81; CLASSIFICATION OF INCOME AND PROFIT AND LOSS ACCOUNTS FOR CARRIERS BY WATER (1913) 15, 21; FORM OF GENERAL BALANCE SHEET STATEMENTS FOR CARRIERS BY WATER (1913) 19-20; Texas Midland Ry, 75 I. C. C. 1 (1918). For similar Interstate Commerce Commission regulations see UNIFORM SYSTEM OF ACCOUNTS FOR EXPRESS COMPANIES (1914) 60, 69, 73, 79; UNIFORM SYSTEM OF ACCOUNTS FOR TELEGRAPH AND CABLE COMPANIES (1914) 10, 49; UNIFORM SYSTEM OF ACCOUNTS FOR TELEPHONE COMPANIES (1913) 14, 23, 53. The provisions for railways are discussed in 2 WHITTEN, VALUATION OF PUBLIC SERVICE CORPORATIONS (2d ed. 1928) 1007, 1137.

[8] In re Janesville Water Co., P. U. R. 1915A 178 (Wis. 1915); Re Baltimore County Water & Electric Co., P. U. R. 1918F 522 (Md. 1918); Re Great Falls Gas Co., P. U. R. 1922D 385 (Mont. 1922); Charleston v. Public Service Commission, P. U. R. 1924B 601 (W. Va. 1923); Commission ex rel. Roanoke v. Roanoke Water Works Co., P. U. R. 1925B 303 (Va. 1924); Re Great Falls Gas. Co., P. U. R. 1928E 803 (Mont. 1928); Re Logan Gas Co., P. U. R. 1929A 232 (Ohio 1929); Re Nashville Ry. & Light Co., P. U. R. 1929A 664 (Tenn. 1929). Additional cases are cited in LAGERQUIST, PUBLIC UTILITY FINANCE (1927) 224, n. 26.

[9] UNIFORM CLASSIFICATION OF ACCOUNTS FOR ELECTRIC UTILITIES (1922), discussed in 2 WHITTEN, *op. cit. supra* note 7, at 1014, 1039.

[10] Minneapolis v. Rand, 285 Fed. 818 (C. C. A. 8th, 1923); Reno Power Co. v. Public Service Commission, 300 Fed. 645 (D. C. Nev. 1921); Galveston Electric Co. v. Galveston, 258 U. S. 388, 42 Sup. Ct. 351 (1922). *Contra:* Ben Avon Borough v. Ohio Valley Water Co., 271 Pa. 346, 114 Atl. 369 (1921).

[11] BAUER, EFFECTIVE REGULATION OF PUBLIC UTILITIES (1925) 219-22; MALTBIE, *op. cit. supra* note 1, at 71; 1 SPURR, GUIDING PRINCIPLES OF PUBLIC UTILITY REGULATION (1925) 380; CLEVELAND AND POWELL, *op. cit. supra* note 6, at 334; LAGERQUIST, *op. cit. supra* note 8, at 229; 2 WHITTEN, *op. cit. supra* note 7, at 1137; Waltersdorf, *State Control of Utility Capitalization* (1928) 37 YALE L. J. 337, 349; BARNES, PUBLIC UTILITY CONTROL IN MASSACHUSETTS (1930) 69. NASH, THE ECONOMICS OF PUBLIC UTILITIES (1925) 128, takes the view that whereas bond discount should not be capitalized, yet brokerage should. For the regulations of the Secretary of the Treasury of the United States in regard to the treatment of bond discounts for income tax purposes see I STANDARD FEDERAL TAX SERVICE (1931) 107.

[12] Many states regulate by statute the purposes for which utilities may issue securities. These statutes are discussed in Waltersdorf *op. cit. supra* note 11, at 338. No statute provides for or prohibits the issuance of stock for this specific purpose. Their general tenor is that stock may be issued only for purposes properly chargeable to capital account.

[13] Permitting issuance: In re Omaha & Lincoln Ry. & Light Co., P. U. R. 1915B 416 (Neb. 1915); Re Omaha, L. & B. Ry., P. U. R. 1917A 907 (Neb. 1916); Re United Electric Power Co., P. U. R. 1928B 641 (R. I. 1927).

While no necessary correlation exists between the capitalization of a utility and the "fair value" on which it is entitled to earn a return,[14] yet any capitalization increases the amount of stock on which investors expect a return. If the stock is issued against items not properly included in the base on which a return may be earned, this capitalization, though increasing the capital on which returns must be paid to investors, does not increase the gross return allowed the utility. The resultant "overcapitalization" impairs the security of the utility and lessens the ease with which it can obtain capital.[15] If commissions are so to supervise utilities as to enable them to render to consumers efficient service, the credit of these concerns must be maintained at its highest possible point. The present decision, interpreting the statute as not authorizing the issuance of stock to cover bond discount, goes far toward achieving this end.

TAXATION OF INCOME FROM SALE OF ROYALTY OIL AND GAS UNDER "CAPITAL GAIN" SECTION OF REVENUE ACT

THE decision of a Federal District Court that the income from the sale of royalty oil and gas is taxable as "capital gain" [1] recently gave rise to considerable excitement among the holders of oil and gas royalties who anticipated substantial savings in income tax payments.[2] This excitement will be somewhat cooled by the news of the reversal of that decision by the Circuit Court of Appeals in *Alexander, Collector of Internal Revenue v. King* [3] where it was held that such income is not taxable as "capital gain" at a 12½ per cent rate but is subject to surtax assessments as "ordinary income." [4]

Since the federal courts have regarded an oil and gas "lease" [5] as merely

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Prohibiting issuance: Re Hampton Waterworks Co., P. U. R. 1918C 171 (N. H. 1918); Re Merchants Heat and Light Co., P. U. R. 1919F 664 (Ind. 1919); Re Penobscot Power Co., P. U. R. 1922E 861 (Me. 1922); Re Missouri Gas & Electric Service Co., P. U. R. 1923C 635 (Mo. 1923); Re Missouri Gas & Electric Service Co., P. U. R. 1924E 84 (Mo. 1924); Re Nevada, California & Oregon Telephone & Telegraph Co., P. U. R. 1927B 662 (Cal. 1926). The cases on this question are discussed in Lagerquist, *op. cit. supra* note 8, at 236.

[14] Exception should be made here to Massachusetts, where a closer correlation than elsewhere exists between capitalization and the amount on which a return may be earned. In such a case, the undesirable effect of "overcapitalization" on rates is clearly apparent. For the Massachusetts situation see BARNES, *op. cit. supra* note 11, at 125.

[15] The relation of "overcapitalization" to consumers is ably discussed in BONBRIGHT, RAILROAD CAPITALIZATION (1920) 13-63; BARNES, *op. cit. supra* note 11, at 125.

[1] King v. Alexander, Collector of Internal Revenue, C. C. H., Vol. III 1930, § 9094 (W. D. Okla. 1930).

[2] See C. C. H., Vol. II 1930 § 4017.

[3] C. C. H., Vol. III 1931 § 9021 (C. C. A. 10th, 1931).

[4] See Revenue Act of 1926, § 208. 44 STAT. 19 (1926), 26 U. S. C. A. § 939 (1928). Act of 1928, § 101. 45 STAT. 811 (1928), 26 U. S. C. A. § 2101 (1928)..

[5] Since the landowner has no corporeal interest which he can lease, the term "lease," though uniformly used, is misleading. See Simonton, *The Nature of the Interest of the Grantee Under an Oil and Gas Lease* (1918) 25 W. VA. L. Q. 295, 325.

transferring a right of *profit à prendre*—an incorporeal interest—to the "lessee," the cash consideration received from such transfer has been held not to be "capital gain" arising from the sale of a "capital asset." [6] The court in the instant case concludes that since the royalty oil, in which the landowner has no corporeal interest until its extraction,[7] is just as much a part of the consideration for the "lease" as is a cash payment, the income derived from the sale of such oil is not to be classified as "capital gain." [8] The opposite result reached by the lower court was based upon two decisions of the Board of Tax Appeals holding that the income from an "outright" sale of a portion of the reserved royalty interest constitutes "capital gain." [9] The instant court sees a distinction between a "lease" and the sale of the reserved royalty interest in that one is a "lease for a term" and the other an "outright sale." [10] A distinction based on this reasoning, however, seems unconvincing in view of the fact that such a "lease" is more properly an absolute grant of a *profit à prendre*, defeasible upon a failure to produce oil or do other acts within a certain time, but lasting until the profit is exhausted if a well comes in.[11]

Yet for purposes of taxation a difference between the income from a sale of a portion of the reserved royalty interest and the income from the "lease," represented by the income from the sale of the royalty oil, may perhaps be justified if viewed in the light of the entire tax program. The federal courts have uniformly held that the income from a mining "lease," either of coal or ore, is ordinary income, the reason being that the "lease" is not the sale of the minerals in place and is therefore not the sale of a capital asset.[12] Accordingly the taxing of income from the sale of the royalty oil as "income" rather than "capital gain" avoids discrimination be-

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[6] Burkett v. Commissioner, 31 F. (2d) 667 (C. C. A. 8th, 1929), *certiorari* denied, 280 U. S. 598, 49 Sup. Ct. 14 (1929); Berg v. Commissioner, 33 F. (2d) 641 (Ct. of App. D. C. 1929), *certiorari* denied, 280 U. S. 598, 49 Sup. Ct. 14 (1929).

[7] Ohio Oil Co. v. Indiana, 177 U. S. 190, 20 Sup. Ct. 576 (1900); Summers, *Legal Interests in Oil and Gas* (1921) 4 ILL. L. Q. 12, 167.

[8] See Ferguson v. Commissioner, C. C. H., Vol. III 1930, par. 9002 (C. C. A. 5th, 1930), supporting the instant decision but *contra* on the question of "cash bonus."

[9] Murphy v. Commissioner, 9 B. T. A. 610 (1927); Reynolds v. Commissioner, 10 B. T. A. 651 (1928); I. T. 2524, IX—1 Cum. Bull. 199.

[10] See *supra* note 3, at 8656. The deed in the Murphy case contained the following words: ". . . do hereby grant, sell and convey unto . . . their successors, heirs and assigns forever, an undivided one half interest in and to all the oil and gas and other minerals in and upon the following described lands. . . . It being the intention by this instrument to convey to the grantees herein what is commonly known as a one sixteenth royalty or one half of the one eighth royalty to come to the lessors in the leases above described." *Supra* note 9, at 612.

[11] See Krutzfeld v. Stevenson, 86 Mont. 463, 476, 234 Pac. 553, 556 (1930). *Cf.* "lease" forms in SUMMERS, OIL AND GAS (1927) 746-759. The right to the royalty is at best no more than a right of *profit à prendre* and is in practical effect less. As the majority of traffic in royalties is in fractions of the one eighth ordinarily reserved by the lessor the interest of the royalty holder is so small that he is precluded from drilling for himself at the expiration of the existing "lease."

[12] United States v. Biwabik Mining Co., 247 U. S. 116, 38 Sup. Ct. 462 (1918); Von Baumbach v. Sargent Land Co., 242 U. S. 503, 37 Sup. Ct. 201 (1916); Rosenberger v. McCaughn, 25 F. (2d) 699 (C. C. A. 3d, 1928).

tween similar industries. Furthermore since the Revenue Act in question expressly provides for deduction for depletion in the case of "mines, oil and gas wells and other mineral deposits" it would seem clear that there was no intention that the income from the transfer of mineral rights by "lease" should be treated as "capital gain" arising from the sale of a "capital asset." [13] On the other hand sales of reserved royalty interests, because they constitute a sale of contingent right to income, seem to be sufficiently analogous to stock and security sales, the profits from which have been regarded as "capital gain,"[14] to call for the same treatment accorded such sales. In addition, by assessing the income from the sale of reserved royalty interests as "capital gain," the general purpose of the "capital gain" section of the Revenue Act is served in that free traffic in such royalties is not handicapped by the fear of prohibitive surtaxes in the year the profit is realized.[15]

FEDERAL INSTRUMENTALITIES AS THE SUBJECT OR MEASURE OF STATE TAXATION

MODERN tendencies of government have lent increasing significance to the "familiar aphorism that 'as the means and instrumentalities employed by the general government . . . are exempt from taxation by the states, so are those of the states exempt from taxation by the general government.' " [1] The expansion of governmental activities has aggravated the demand for revenues and also widened the range of possible immunity from taxation.[2] To some members of the Supreme Court these tendencies have seemed to call for renewed vigilance lest traditional exemptions be disregarded in the desperate search for additional revenues; [3] other members have been more concerned to avoid hampering taxation unnecessarily by a "mechanical application of the rule . . . regardless of the consequences to government." [4] This division of opinion was apparent in the familiar cases of *Long v. Rockwood* [5] and *Panhandle Oil Co. v. Mississippi*,[6] which extended

[13] See § 204 (c) of the Revenue Act of 1926. 44 STAT. 14 (1926), 26 U. S. C. A. § 935 (1928); Stratton's Independence v. Howbert, 231 U. S. 399, 34 Sup. Ct. 136 (1913).

[14] Gilbert's Estate v Commissioner, 20 B. T. A. 765 (1930); I. T. 2502 VIII—2 Cum. Bull. 128 (1930); C. C. H., Vol. II (1930) par. 4007. Of course the stock must not be part of the seller's stock in trade.

[15] See Report of Committee on Ways and Means, p. 10, quoted in instant case; *supra* note 3, at 8053.

[1] See Willcuts v. Bunn, 51 Sup. Ct. 125, 126 (1931).

[2] See Cohen and Dayton, *Federal Taxation of State Activities and State Taxation of Federal Activities* (1925) 34 YALE L. J. 807, 825; 4 THE NEW REPUBLIC 284 (Jan. 28, 1931).

[3] See dissenting opinion in Educational Films Corporation of America v. Ward, 51 Sup. Ct. 170 (1931).

[4] See majority opinion in Educational Films Corporation of America v. Ward, *supra* note 3.

[5] 277 U. S. 142, 48 Sup. Ct. 463 (1928).

[6] 277 U. S. 218, 48 Sup. Ct. 451 (1928). A recent decision of the Supreme Court is of some interest in this connection. A suit was brought in the Court of Claims by the State of Alabama to collect a tax on the sale by the United States of power generated at its dam at Muscle Shoals. The dismissal of the suit was affirmed "not upon the merits" but "for want of jurisdiction." Alabama v. United States, U. S. Daily, Feb. 25, 1931, at 3942.

immunity to royalties from patents and profits from sales of gasoline to the United States government. It appears again with the erstwhile dissenters now in the majority, in *Educational Films Corporation of America v. Ward*,[7] which sustains the right of the State of New York to include in the taxable net income of a corporation royalties received from the licensing of copyrights.

The majority opinion, written by Mr. Justice Stone, avoids the question whether copyrights, like patents are government instrumentalities, by resting the decision upon the ground that the income of the corporation was not the subject but the measure of the tax, which was levied upon the privilege of exercising the corporate franchise. For the distinction between the subject and the measure of a tax there is ample authority,[8] culminating in *Flint v. Stone Tracy Co.*[9] which upheld a federal tax levied upon the corporate franchise and measured by the entire corporate income, including interest on tax-exempt municipal bonds. But it has been suggested that this is a distinction without substance, likely to be abandoned or devitalized by the Supreme Court, lest it serve as a cloak for the taxation of federal instrumentalities.[10] This prediction seemed partially fulfilled in the case of *Macallen Co. v. Massachusetts* [11] which characterized the *Flint* case as an "extreme example" and prohibited the inclusion of income from federal securities in the measure of a state franchise tax. Thanks to the attempt of the Court in the *Macallen* case to distinguish it from the *Flint* case by reference to the legislature's "specific intent" to reach tax-exempt securities, Mr. Justice Stone is able to make the same distinction between the principal case and the *Macallen* case although the facts are essentially similar.[12] Thus, without any overt overruling of precedent, the doctrine that the measure of a tax may include tax-exempt property is restored to favor.

But the majority opinion admits, and the dissenting opinion insists, that it is the duty of the court to determine whether what the legislature has designated as the measure of the tax is not in fact its subject. The arbitrary character of that determination is well illustrated in both opinions. The dissenters point to a decision of the New York Court of Appeals in which, in order to hold unconstitutional a particular provision of the statute involved in the principal case, it characterized the tax as "in substance, though not in form, in tendency, though not in name . . . equivalent to a tax upon relator's income." [13] The majority points with equal persuasiveness to a later opinion of the same court which, in order to hold the rest

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[7] *Supra* note 3. Justices Sutherland, Van Devanter, and Butler dissented.

[8] Hamilton Company v. Mass., 6 Wall 635 (1868); Society for Saving v. Coite, 6 Wall. 594 (1868); Provident Institute v. Mass., 6 Wall. 611 (1868); Home Ins. Co. v. N. Y., 134 U. S. 594, 10 Sup. Ct. 593 (1890); Plummer v. Coler, 178 U. S. 115, 20 Sup. Ct. 829 (1900).

[9] 220 U. S. 107, 31 Sup. Ct. 342 (1911).

[10] Isaacs, *The Subject Measure of Taxation* (1926) 26 COL. L. REV. 939.

[11] 279 U. S. 620, 49 Sup. Ct. 432 (1929).

[12] The court in the Macallen case based its finding of intent largely upon the fact that the legislature had passed an amendment which removed from the original act the specific exclusion of federal securities. But the statute involved in the principle case had been twice amended, once to include "all interest from federal, state, municipal or other bonds" and again to include "income from any source." *Cf.* Miller v. Milwaukee, 272 U. S. 713, 47 Sup. Ct. 280 (1927).

[13] People ex rel. Alpha Portland Cement Co. v. Knapp, 230 N. Y. 48, 56, 129 N. E. 202, 205 (1920).

of the statute constitutional, labeled it as "primarily a tax levied for the privilege of doing business in the state." [14] But whichever of these labels be accepted, the fundamental problem is unaffected, for whether the particular tax be on franchise or income its interference, if any, with the functions of copyrights is identical.[15] Thus the distinction between subject and measure appears to be not so much a basis as a form of decision, perhaps a convenient method of retreat from the extreme to which the doctrine of the immunity from taxation of federal instrumentalities has been lately carried.[16] The real justification for the result may be found in Mr. Justice Stone's supplementary argument—an echo of his own and Mr. Justice Holmes' dissents in previous cases [17]—that "viewed in the light of actualities" the tax imposes no "such real or direct burden on government as to call for the application of a different rule."

Right of Preferred Shareholders to Dividends on Dissolution

In view of the present business depression and the consequent dissolution of many business enterprises the recent case of *Penington v. Commonwealth Hotel Corp.*[1] presents a matter of some importance to corporate shareholders. The charter of this corporation provided that upon liquidation of the corporation a preference was to be allowed the preferred shareholders of the par value of their preferred shares "and all unpaid dividends accrued thereon." Although no profits were ever earned, a surplus remained after the creditors of the corporation had been paid and the preferred shareholders had received the par value of their shares. Reversing the decree of the Chancellor,[2] the Delaware Supreme Court held that the preferred shareholders were entitled to an additional preference out of this surplus to the extent of the unpaid accrued dividends.

Since it is rather unusual for a corporation which has earned no profit over a period of years to have a surplus upon liquidation after paying off both its creditors and the par value of its outstanding preferred shares, it is not strange that there are few adjudicated cases dealing with the situation in the principal case. In England it was first held [3] that a provision for a preference to the preferred shareholders of "arrears (if any) . . . of dividends" applied only if the surplus remaining after preferred payments was a profit, since there could be no "dividends" unless there were "earnings." The English court subsequently expressly overruled [4] this holding on the ground that there is a distinction between the division of surplus assets, with which the court was dealing, and the declaration of a dividend.[5] But in a more recent case, the same court fastened on the word

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[14] People ex rel. Bass, Ratcliffe & Gretton, Ltd., v. Tax Commission, 232 N. Y. 42, 46, 133 N. E. 122 (1921); *aff'd*, 266 U. S. 271, 45 Sup. Ct. 82 (1924).

[15] For an excellent discussion of the fundamental problem see Metcalf & Eddy v. Mitchell, 269 U. S. 514, 46 Sup. Ct. 172 (1925).

[16] *Cf.* (1930) 40 YALE L. J. 136.

[17] See Panhandle Oil Co. v. Mississippi, *supra* note 6, at 222, 48 Sup. Ct. at 453; Macallen Co. v. Massachusetts, *supra* note 11, at 634, 49 Sup. Ct. at 437; Long v. Rockwood, *supra* note 5, at 148, 48 Sup. Ct. at 465.

[1] U. S. Daily, Jan. 30, 1931, at 3648 (Del. 1931).

[2] 151 Atl. 228 (Del. Ch. 1930).

[3] In re W. J. Hall & Co., Ltd., [1909] 1 Ch. 521. See note 6 A. L. R. 822 (1920).

[4] In re Springbok Agricultural Estates, Ltd., [1920] 1 Ch. 563; In re Dominion Tar & Chemical Co., Ltd., [1929] 2 Ch. 387.

[5] See In re New Chinese Antimony Co., Ltd., [1916] 2 Ch. 115, 118.

"due," in the phrase "arrears of dividends due," to hold that dividends, payable to the preferred shareholders on liquidation, included only those earned.[6]

Prior to the principal case, the American courts which dealt with this specific matter were divided. The New York Appellate Division [7] followed the earlier English cases, while the Virginia court [8] reached the opposite conclusion by adopting the reasoning of the later English decisions. The effect of the instant holding is to place the preferred shareholders in a position not unlike that of debenture holders entitled to the payment of interest on their investment.[9] It would seem that if the parties had intended such a result they would probably have used a substitute for the word "dividends" which conventionally, at least, includes payments only out of profits.[10]

Protection from Collateral Attack Accorded Investors in Municipal Bonds

Investors in municipal corporation bonds have frequently found their security reduced to mere pieces of paper when courts have been led to declare such an issue invalid.[1] The desirability of safeguarding such investors manifests itself in a trend, both in legislation and judicial decision, toward immunizing the validity of such bond issues from collateral attack. This trend is indicated in the case of *Penton v. Brown Crummer Investment Co.*[2] where municipal bondholders successfully enforced an assessment lien given as security for the bond issue despite the collateral attack of a property owner based upon an alleged lack of a quorum at the meeting of the City Council at which the bonds were authorized.

The rule appears well established that the action of a municipal corporation in issuing bonds cannot be attacked collaterally for mere irregularities or formal defects.[3] Nor may a collateral attack be made upon the legal existence of the municipality since its *de facto* existence and activity will be sustained until questioned in a direct proceeding of *quo warranto*.[4] But where the objection is based upon the exercise of power or authority by the municipality beyond the scope of its charter or the failure to comply with some condition precedent to valid activity, collateral attack is gen-

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[6] In re Roberts & Cooper, Ltd., [1929] 2 Ch. 383. See Note (1930) 30 Col. L. Rev. 118.

[7] Michael v. Cayey-Caguas Tobacco Co., 190 App. Div. 618, 180 N. Y. Supp. 532 (1st Dep't 1920).

[8] Drewry, Hughes Co. v. Throckmorton, 120 Va. 859, 92 S. E. 818 (1917); Johnson v. Johnson & Briggs, 138 Va. 487, 122 S. E. 100 (1924).

[9] See Note (1930) 30 Col. L. Rev. 118.

[10] *Cf.* In re Espuela Land & Cattle Co., [1909] 2 Ch. 187 (preferred shareholders entitled to "interest" but not "dividends" on dissolution).

[1] See Robertson v. Rural Special School District No. 9, 155 Ark. 161, 244 S. W. 15 (1922); Bristow Battery Co. v. Payne, 123 Okla. 137, 141, 252 Pac. 422, 426 (1926); with which *cf.* Board of Comm'rs of Rogers County v. Bristow Battery Co., 28 F. (2d) 195 (D. Okla. 1928).

[2] 131 So. 14 (Ala. 1930).

[3] Daly v. Gubbins, 170 Ind. 105, 82 N. E. 659 (1907); 6 McQuillan, Municipal Corporations (2d ed. 1928) § 2513.

[4] Albuquerque v. Water Supply Co., 24 N. M. 368, 174 Pac. 217 (1918); Cook v. Town of Putnam, 283 S. W. 649 (Tex. Civ. App. 1926); *cf.* Payne v. First National Bank, 291 S. W. 209 (Tex. Civ. App. 1927) (collateral attack on *de facto* existence of municipal corporation not allowed although where the objection is based upon the exercise of power or authority by its *de jure* existence had been terminated by *quo warranto* proceedings).

erally permissible,[5] even though the time for direct appeal has already expired.[6] When assessment liens underlie bond issues a difficult choice is presented between the protection of the land owner's right of property and protection of innocent purchasers for value of the bonds.[7] It would seem that this choice should be resolved in favor of the bondholder both because the taxpayer has had an opportunity for direct attack, and because a careful search of the records of the municipality by the bondholder is frequently neither feasible nor certain to reveal the lack of authority. The doctrine of "estoppel by recitals" developed in the United States Supreme Court and followed by several state courts indicates the trend in this direction.[8] Thus where the proper officers make recitals in the bonds which import compliance with the municipal charter and with all conditions precedent to a valid exercise of municipal authority, a bona fide purchaser of the bonds need not inquire further into the charter, the municipal record, or the actual proceedings, and the recitals are conclusive against any defense of want of jurisdiction.[9] The instant case goes even farther in holding that, where a clerk keeps a record of municipal meetings as required by law, this record may not be impeached collaterally.[10]

The greatest protection which bond holders have yet received has been accorded by a few states which allow what amounts to a declaratory judgment of validity.[11] This procedure takes the form of an action between the municipality, its taxpayers and the state to show cause why the bonds should not be validated.[12] Once validated the determination is conclusive and after final judgment or expiration of the time for direct appeal no further attack, direct or collateral, is permitted.[13] The extension of this device would seem to be the most satisfactory method of assuring the purchaser of municipal bonds protection against any defects in the jurisdiction, authority, or procedure of the municipality.

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[5] Benwood v. Wheeling Ry., 53 W. Va. 465, 44 S. E. 271 (1903); Wooten v. Texas Bitulithic Co., 212 S. W. 248 (Tex. Civ. App. 1919). See Green v. City of Rock Hill, 149 S. C. 234, 256, 147 S. E. 346, 358 (1929).

[6] Vreeland v. Tacoma, 48 Wash. 625, 94 Pac. 192 (1908); Wooten v. Texas Bitulithic Co., *supra* note 5.

[7] See instant case, *supra* note 2, at 17.

[8] Presidio County v. Noel Young Bond Co., 212 U. S. 58, 29 Sup. Ct. 237 (1908); Clapp v. Otoe County, 104 Fed. 473 (C. C. A. 8th, 1900), *certiorari* denied, 180 U. S. 638, 21 Sup. Ct. 920 (1900); Andes v. Ely, 158 U. S. 312, 15 Sup. Ct. 954 (1894). With these cases compare the earlier cases of Nesbit v. Riverside Independent District, 144 U. S. 610, 12 Sup. Ct. 746 (1891). (*contra*). In the state courts: City of Laredo v. Frishmuth, 196 S. W. 190 (Tex. Civ. App. 1917); Marr v. Southern California Gas Co., 198 Cal. 278, 245 Pac. 178 (1926); Cuddy v. Sturtevant, 111 Wash. 304, 190 Pac. 909 (1920).

[9] See Presidio County v. Noel Young Bond Co., *supra* note 8, at 65, 29 Sup. Ct. at 239.

[10] See instant case, *supra* note 2, at 20.

[11] FLA. GEN. LAWS (Skillman, 1927) Vol. 2, §§ 5106-5129; GA. ANN. CODE (Michie, 1926) §§ 445-462; MISS ANN. CODE (Hemingway, 1927) Vol. 2, §§ 4176-4780. In California the method is provided as to each class of bonds authorized. CAL. GEN. LAWS (Deering, 1923) art. 9125, § 15 is typical.

[12] The Florida procedure is outlined in Ingram v. City of Palmetto, 93 Fla. 790, 112 So. 861 (1927).

[13] FLA. GEN. LAWS (Skillman, 1927) Vol. 2, § 5109; GA. ANN. CODE (Michie, 1926) § 448; MISS. ANN. CODE (Hemingway, 1927 Vol. 2, § 4178; Thomas v. City of Blakely, 141 Ga. 488, 81 S. E. 218 (1914); *cf.* Fidelity National Bank & Trust Co. v. Swope, 274 U. S. 123, 47 Sup. Ct. 511 (1927).