Notes

RETROACTIVE EFFECT OF AN OVERRULING DECISION

Upon a legal system there are continuously pressed two necessarily antithetical demands—the demand for stability in judicial action and the insistence that pre-existing rules shall be altered in line with changing conceptions of social policy. In the conflict between them, stare decisis becomes modified from a principle of rigid adherence to precedent to a discretionary rule of action under which prior decisions will at times be abandoned. Usually, earlier holdings are later disregarded without being overruled. By merely distinguishing, ignoring, or limiting them, courts are able to conceal reversals and thus to avoid the question of what effect should be given an overruling decision. In some instances, however, a court feels the necessity of admittedly abandoning a former position, and it is then forced to face the problem. The rejected precedent may be regarded as never having had any validity, in which case the overruling decision would have to be applied retroactively to fill the gap in the law thus created. Or the court may consider that the precedent now overruled was nevertheless the law until the time of its abandonment, and that the new ruling is to apply only prospectively.

Attention has been focused primarily upon the hardship which a rigid adherence to the former of these views imposes upon those who have acted on

1. Pound, Interpretations of Legal History (1923) 1; Cardozo, the Growth of the Law (1924) 1, 143; Hardman, Stare Decisis and the Modern Trend (1928) 32 W. Va. L. Q. 163; Carpenter, Stare Decisis and Law Reform (1927) 1 So. Calif. Rev. 53.
4. See Sharp, Movement in Supreme Court Adjudication—A Study of Modified and Overruled Decisions (1933) 46 Harv. L. Rev. 361, 693.
5. This is the so-called declaratory theory of Blackstone. See 1 Bl. Comm. *69-71.
6. This doctrine has been urged especially by Austin, Jurisprudence (6th ed. 1885) 634, and Gray, The Nature and Sources of the Law (2d ed. 1921) 222 et seq.
7. There is some confusion as to the meaning of prospective and retrospective operation. A few writers appear to hold the belief that the former embraces the overruling case itself but not other litigation arising during the interval between the establishment of the precedent and its rejection. The courts, however, have drawn no such distinction and there appears to be little basis for it, since the decision of the overruling case is enunciated subsequent to the occurrence of the operative facts giving rise to that case as well as after the happening of those inducing the other litigation.

[779]
the strength of precedent. This emphasis has resulted in frequent rejection of that theory to the extent of excepting from the operation of its rule of retroaction situations involving the interpretation of statutes or constitutional provisions in which rights have been acquired under an earlier dissimilar construction. Support for this position has often been sought in various constitutional doctrines. But while the Supreme Court has indicated in diversity of citizenship cases its disfavor of the retroactive application of an overruling state decision where retroaction would result in hardship, it does not view the giving of retroactive effect by a state court to an overruling decision as violative of any federal guarantees. It is now definitely established that the prohibitions against state action impairing the obligation of contracts and enforcing ex post facto laws are directed only against the legislative bodies of the states. And although the due process clause is not thus circumscribed, such action by a state court is not regarded as within its purview.

8. A few courts have repudiated outright the doctrine of retroaction. Commonwealth v. Fidelity & Columbia Trust Co., 185 Ky. 300, 215 S. W. 42 (1919); Harris v. Jex, 55 N. Y. 421 (1874); Bond Debt Cases, 12 S. C. 200, 232 (1879); Vermont and Canada Railroad Co. v. Vermont Central Railroad Co., 63 Vt. 1, 21 Atl. 262 (1890). The greater number of courts, however, have achieved the result sought by indirect means. Of these, some have held that the earlier construction of a statute, though erroneous, became a part of that statute for the intervening period, as though written into it. Other courts have made an exception to the doctrine in instances involving statutes and constitutional provisions, while outwardly continuing to profess allegiance. See the cases collected in Freeman, The Protection Afforded Against the Retroactive Operation of an Overruling Decision (1918) 18 Col. L. Rev. 299; in Von Moschzisker, supra note 3; Hoven v. McCarthy Brothers Co., 163 Minn. 339, 204 N. W. 29 (1926); Wilkinson v. Wallace, 192 N. C. 156, 134 S. E. 401 (1926); State v. Haid, 327 Mo. 607, 38 S. W. (2d) 44 (1931).


9. See generally, Freeman, supra note 8. Illustrations in recent cases are to be found in Fleming v. Fleming, supra note 8; Tidal Oil Co. v. Flanagan, 263 U. S. 444 (1924). Cf. State v. Greer, 88 Fla. 249, 102 So. 739 (1924).

10. Gelpeke v. City of Dubuque, 1 Wall. 175 (U. S. 1863); Douglass v. County of Pike, 101 U. S. 977 (1879); Tidal Oil Co. v. Flanagan, supra note 9. The cases are collected in Jackson v. Harris, 48 F. (2d) 513 (C. C. A. 10th, 1930).

11. See Tidal Oil Co. v. Flanagan, supra note 9 (authorities collected).


14. See Central Land Co. v. Laidley, 159 U. S. 103, 112 (1895); Tidal Oil Co. v. Flanagan, 263 U. S. 444, 450 (1924); Brinkerhoff-Faris Trust & Savings
Recent litigation has for the first time brought before the Supreme Court the converse of the above situation. In two companion cases the Supreme Court of Montana had reconsidered the proper interpretation to be placed upon a state statute empowering the Board of Railroad Commissioners to initiate intrastate rates. Under a prior construction shippers could compel restitution by a carrier upon later proof of the unreasonable or discriminatory character of the authorized charges. The court was desirous of overruling this interpretation as irrational and contrary to the established authority in other jurisdictions, but felt that a new ruling should not be permitted to work to the injury of the contesting shippers and others whose legal behavior had presumably been affected by reliance upon the earlier decision. It therefore declared the previous interpretation erroneous but rendered judgment for the shippers, stating that the altered construction was to be given only prospective application. The defendant railroad appealed from these decisions, emphasizing the perverse effect of such a view upon those litigants who seek the abandonment of precedent. It urged as palpably unfair a philosophy of stare decisis which prompts a court to enter judgment against a party while acknowledging the correctness of that party's exposition of the law. Resort was again had to constitutional doctrines for support; the action of the Montana court in refusing to give retroactive effect to its new decision was said to deny the railroad due process of law. But while the Supreme Court recognized the novelty of this claim to the protection of the Constitution, it concluded that the contention was without merit.

In reaching this conclusion the Court entertained the view that no distinction is to be drawn between the position of the litigant who seeks to have an overruling declaration operate only prospectively and the position of the one who desires its retroactive application. Consequently, its consistent denial of constitutional protection in the former situation seemed logically to require the

Co. v. Hill, 281 U. S. 673, 680 (1930); Freeman, supra note 8, at 239; McKean, The Rule of Precedents (1928) 76 U. of Pa. L. Rev. 481, 488; Note (1928) 23 Col. L. Rev. 619, 627. Muhlker v. New York and Harlem Rr. Co., 197 U. S. 544 (1905), though appearing to indicate a contrary position, has been distinguished on the ground that legislative action was involved. Tidal Oil Co. v. Flanagan, 263 U. S. 444, 452 (1924); Freeman, supra note 8, at 237-238. Nor is the decision in the Brinkerhoff-Faris case, supra, in conflict. Reversal of the state decision was occasioned by the fact that it had operated to deny due process "in its primary sense of an opportunity to be heard and to defend one's substantive right."

15. Montana Horse Products Co. v. Great Northern Ry. Co., 91 Mont. 194, 7 P. (2d) 919 (1932); Sunburst Oil & Refining Co. v. Great Northern Ry. Co., 91 Mont. 216, 7 P. (2d) 927 (1932).
16. 1 MONT. REV. CODE (Ghoate, 1921) § 3794.
18. See Note (1932) 41 YALE L. J. 625.
19. Where a court adopts this method of solving the problem, it may be queried what will later be taken as stare decisis—what the court actually did in the overruling case or what it there said with reference to future policy. Cf. Von Moschzisker, supra note 3, at 426; Carpenter, supra note 1, at 58.
20. The carrier challenged the ruling in these decisions by securing a writ of certiorari in the second of the two. The case reviewed by the Supreme Court was that of Great Northern Ry. Co. v. Sunburst Oil & Refining Co., 53 Sup. Ct. 145 (1932).
same result in the latter. It may be questioned, however, whether even as much can be said in support of the position championed by the carrier. Retroaction, underlain by a highly artificial theory of law, imposes a real hardship through its disregard of the reasonable expectations of the party who has relied on precedent; whereas prospective operation, while also exacting a kind of legal martyrdom, does not involve for the party challenging precedent any corresponding frustration of understanding as to legal status. Moreover, with retroactive effect, reversals in judicial attitude are necessarily attended by greater disturbances in the legal system, for they can be secured only at the cost of creating a state of uncertainty even with respect to the law obtaining prior to the date of overruling.

In any event, there can be no quarrel with the Court's adoption of a policy of non-interference in regard to this whole problem in judicial mechanics. There exists strong support for the feeling that an individual litigant cannot be heard to complain if a court, in its effort to rid the law of unsatisfactory precedents, adopts a theory regarding the operation of overruling decisions which is adverse to that individual's interests; certainly the injury that may be done is not commensurate with the confusion which would undoubtedly follow upon any attempt on the part of the Federal Court to dictate to state courts its own doctrine of stare decisis. That Court, in the instant litigation, wisely regarded the problem as one in judicial discretion rather than in constitutional law and determined to continue in its policy of leaving the state courts to work out independently of constitutional exactions, as they are now endeavoring to do, their own conceptions of "the binding force of precedent" and "the meaning of the judicial process."

**STATUS OF CERTIFICATE HOLDER ENTITLED TO PERCENTAGE OF RECEIPTS**

ATTEMPTS in business financing to secure at the same time the advantages of one form of investment and the immunities of another have within the past half dozen years resulted in a variety of more or less mongrel situations which


22. Where there is no evidence of actual reliance, this generalization would presumably not be true, and retroaction has at times been permitted in such situations. Hibbits v. Jack, 97 Ind. 570 (1884); Nickoll v. Racine Cloak & Suit Co., 194 Wis. 298, 216 N. W. 505 (1927). Reliance is conclusively presumed in most cases, however. A distinction could also be drawn in the case of the litigant seeking the overruling of precedent, between the party who is frequently involved in similar litigation and thereby possibly compensated for the burden thrown upon him by adherence to the rule of prospective operation, and the individual whose only concern is in the outcome of immediate litigation.

23. Cardozo, op. cit. supra note 1, at 122.

24. Freeman, supra note 8, at 247.
courts have been reluctant to classify in better known categories. Such financing has often taken the form of an issue of certificates by the business enterprise setting forth various contractual relations thereby created and agreed to between the firm and the individual investor, and presumed to be beneficial to the latter. Such contractual relations may of course be infinitely varied, and the judicial process of fitting each litigant who comes before the court in cases governed by such contracts into one of the few standardized legal norms for the determination of liability—such as creditor, stockholder, or copartner—becomes purely Procrustean. In the usual case, calling such a certificate holder a copartner, joint adventurer, or creditor, or stating that he is "like a stockholder," can hardly be taken to mean more than that, in the particular case, he is to be subjected to liabilities, or granted immunities, as though he were in such a category.

Where, for example, the certificate holder is simply to receive a certain percentage of the gross receipts of the business, it has been held, in general, that no liability as a copartner is thereby incurred; whereas a sharing of profits is in general interpreted prima facie to involve the certificate holder as a joint enterpriser. A share of profits has, however, been interpreted as mere rental,

1. Cases involving "compromise securities" of the sort referred to first appeared in 1926. See Note (1927) 76 U. of Pa. L. Rev. 80; Note (1928) 28 Col. L. Rev. 65.

2. In addition to the principal case, infra note 11, see cases cited infra notes 9 and 10. A novel form of such certificate financing occurs in Harris Trust and Savings Bank v. Chicago Rys. Co., 56 F. (2d) 942 (C. C. A. 7th, 1932).

3. This is usually done through the application of the various tests evolved in more or less analogous cases. For example, use is made of the proposition that a preferred stockholder, with whom the certificate holder is closely compared, is not a creditor, Spencer v. Smith; 201 Fed. 647 (C. C. A. 8th, 1912); Hazel Atlas Glass Co. v. Van Dyk and Reeves, 8 F. (2d) 716 (C. C. A. 2d, 1925); In re G. L. Miller and Co., 35 F. (2d) 966 (S. D. N. Y. 1929), aff'd, 35 F. (2d) 963 (C. C. A. 2d, 1929); Elko Lamoille Power Co. v. Commissioner of Internal Revenue, 50 F. (2d) 595 (C. C. A. 9th, 1931). But the holder of a so-called preferred stock certificate may nevertheless be a creditor if the certificate matures at a fixed date, Best v. Oklahoma Mill Co., 124 Okla. 135, 255 Pac. 1005 (1926). Any measure of control by the certificate holder analogizes his status to that of a stockholder. Additional tests, such as the sharing of gross receipts or profits, or "holding out" by the parties, are discussed below.

4. Such statements in the opinion of In re Hawkeye Oil Co., infra note 10, for example—that certificate holders were like stockholders or sleeping partners—could hardly be construed to mean necessarily that a copartnership relation existed for all purposes.


6. Miller v. Simpson, 107 Va. 476, 59 S. E. 378 (1907). See extensive annotation, 18 L. R. A. (n.s.) 962, particularly cases cited at 1000. According to more recent cases, a mere sharing of profits is not sufficient in case it is shown that the sharing of profits was for certain special purposes, such as paying a debt, wages, or rent. Hackney Co. v. Robert E. Lee Hotel, infra note 7. The view of the Uniform Partnership Act is significant as to the sharing of both gross returns and profits:
where a hotel rather than money was supplied; 7 and a number of cases have arisen in which the sharing of gross receipts has been held to involve a forfeiture of a general creditor's rights, and even, in one case at least, to incur copartnership liability. 8 Thus where a grocery-vending corporation operating a retail store sold "certificates of ownership" in the store to individuals entitling them to distributive shares of a certain percent of the gross receipts, such certificate holders were held liable to the general creditors of the store for goods sold to it. 9 It has become a common practice to finance gasoline service stations through the issue of certificates entitling their holders to distributive shares of a fund created by reserving one cent per gallon from the proceeds of all gasoline sold until the certificate holders received double the amount paid for the certificates. The cases arising under this scheme of financing have involved the order of priority of claims of certificate holders and of general creditors when the firm became insolvent; and it has been uniformly held that claims of the general creditors are senior. 10

This is essentially the question decided, upon a different fact situation, in the recent case of In re Lathrap 11 by the Circuit Court of Appeals of the Ninth Circuit. Here the individual lessee of an oil well sold certificates purporting to assign to the holder of each certificate one percent of the gross proceeds received from the sale of all oil extracted from the well. The certificate declared that it created simply a vendor-vendee relationship between the parties, and that the holder was not a copartner. Upon the bankruptcy of the lessee the trustee petitioned for an order as to the priority of claims of the certificate holders to proceeds from the sale of oil. The court found that the certificate holders were not vendees, nor were they creditors of the bankrupt, but claimants to the residium of the estate after creditors had been paid.

While the court compares the status of these certificate holders with that of creditors, stockholders, preferred stockholders, joint adventurers, and copartners, it is careful to identify it with none of them. This appears to be the most satisfactory analysis of such a situation that has been attempted, for it is clearly recognized that the liability of the certificate holder may not be measured by forcing him into any of the better known categories. His position is not so favorable as that of a "creditor," which disposes of the only issue raised in the case; but at the same time the court reserves the right to hold, if it should so desire, that the certificate holder may not be

§ 7 (Rules for Determining the Existence of a Partnership) (3) The sharing of gross returns does not of itself establish a partnership . . . . (4) The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business . . . .

8. See cases cited infra notes 9 and 10.
10. United States and Mexican Oil Co. v. Keystone Auto Gas and Oil Service Co., 19 F. (2d) 624 (W. D. Pa. 1924); In re Hawkeye Oil Co., 10 F. (2d) 151 (D. Del. 1927); Massachusetts Gasoline and Oil Co. v. Go-Gas Co., 259 Mass. 585, 166 N. E. 871 (1927). In the last two cases an attempt by certificate holders to assert a lien upon property of the service station was denied. In the Hawkeye Oil Co. case, the certificates were secured by a mortgage on such property.
11. 61 F. (2d) 37 (C. C. A. 9th, 1932).
held liable as a joint adventurer. The speculative nature of the certificate holder's investment, whereby he may, if and so long as things go well, receive an abnormally high rate of return, inclines the court to require him to pay for this advantage by subordinating his claim, when things go ill and there is a shortage of assets, to claims of general creditors who can in no event receive more than a fixed contract sum. If, however, upon the suit of a creditor, it is sought to hold the certificate holder liable as a joint adventurer, other considerations may become of controlling importance—such as, for example, the "holding out," or "appearances" created by the contracting parties and upon which third persons must rely as to the ownership and financial status of the business. Of particular importance among these "appearances" as to the status of certificate holders is the status which the certificates themselves occupy in the financial statement of the business, upon which commercial agencies, and therefore creditors, must rely. For purposes of determining the tort liability of the certificate holder, upon the same reasoning, still other factors may become of particular significance. Clearly this nondescript investor-enterpriser, in his varying guises, must be dealt with as cui gcncrio in particular cases in which he appears—with, at most, discreet analogies from the recognized categories.

RETALIATORY TAXATION OF FOREIGN INSURANCE CORPORATIONS

ALTHOUGH reciprocal and retaliatory statutes applying to the taxation of foreign insurance corporations have existed for many years in a majority of the states, the constitutionality of such statutes has not been before the Supreme Court of the United States since 1886. Then in Philadelphia Fire Association v. New York the Court upheld a New York statute which included provisions
for a future increase in the fees of foreign corporations for permission to engage in business in that state, corresponding with any increase which might be imposed in the state of origin for licenses for foreign corporations to engage in business there. The basis of the decision was that until a foreign corporation had paid the required fee it was not a person within the jurisdiction of New York, and was consequently not entitled to the benefit of the "equal protection" clause. There has been no decision by the Supreme Court regarding the constitutionality from the viewpoint of the same clause of retaliatory statutes imposing franchise taxes on foreign corporations which have already been granted licenses. But in Hanover Fire Insurance Co. v. Harding, the Supreme Court made a sharp distinction between the two situations in holding unconstitutional an Illinois statute which assessed the personal property taxes of foreign insurance corporations on a higher basis than those of domestic corporations. It declared that when a corporation had become entitled to the privilege of doing business within a state it thereby acquired the benefit of the "equal protection" clause to the extent that no taxes may thereafter be imposed which do not fall with equal weight on all corporations of the same class, domestic and foreign. This language may constitute a warning.

It has been frequently stated that retaliatory statutes being penal in character should whenever possible receive a construction in favor of the taxpayer. The contrary construction was, however, recently placed on an Illinois statute which provides that if the state of origin of an insurance company licensed in Illinois should impose on foreign corporations engaged in business in that state a higher tax than the usual Illinois privilege tax on foreign corporations, the corporations of that state should pay in Illinois privilege taxes in accordance with the statutes of the state of their origin. The Illinois rate is 2% annually on gross premiums from contracts covering risks within Illinois, less deductions for premiums paid for reinsurance and for dividends to policy holders. The Ohio rate is 2-1/2%, less deductions for premiums received for reinsurance; no deduction being allowed for dividends to policy holders. A tax had been imposed on an Ohio corporation which had paid substantial premiums for reinsurance of its Illinois contracts, on the basis of the Ohio rate and the Ohio deduction scheme. Consequently, no deduction had been allowed for the reinsurance premiums. These premiums had been paid to corporations subject to taxation in Illinois for all reinsurance on risks within the state. The corporation argued that there was thus created a double tax as to those risks which it had elected to reinsure, a result which should have been avoided by the calculation of the tax in accordance with the Ohio rate, but with the allowances for deductions granted by the Illinois statute. The court, however, declaring that reinsurance contracts are distinct from primary

7. ILL. REV. STAT. (Smith-Hurd, 1931) c. 73, § 68.
8. Id. § 67.
9. OHIO GEN. CODE (Page, 1926) § 5433.
contracts,10 and as such separately taxable, concluded that since the Ohio rate was higher than the Illinois rate, it was mandatory to apply in addition the Ohio deduction scheme.11

This construction of the Illinois statute would permit foreign corporations making a practice of reinsuring their Illinois risks and having their origin in states which, like Illinois, allow a deduction for premiums paid for this reinsurance to obtain lower taxes than corporations whose state of origin does not grant a similar deduction. And corporations any portion of whose Illinois business constitutes reinsurance and whose state of origin, like Ohio, permits a deduction for premiums received for carrying reinsurance, would obtain a lower rate than the corporations of states which do not allow similar deductions. In either instance the assessment of the tax would be based not only on a higher rate obtaining in a foreign state, but also on the allocation of the business of a particular company between direct insurance and reinsurance, and upon allowances for deductions based on policies possibly purely local to the foreign state.12 Moreover, it is by no means certain that Ohio would apply its own retaliatory statute13 to Illinois corporations writing reinsurance there by employing the Illinois deduction scheme in order to arrive at a higher tax than would result from a computation based on the statutes applicable to all foreign corporations.14 On the contrary, the courts of most states have manifested a tendency to approve taxes based upon whichever deduction scheme would produce for the particular litigant the tax least in excess of the basic rate applicable to foreign corporations doing business in that state.15

The court's approval of a tax based on the Ohio rate and the Ohio deduction scheme in the instant case would appear to arrive at a result contrary to the legislative intent of both Illinois and Ohio. Both deduction schemes are obviously framed to avoid the burden of a double tax on reinsurance written within those states.16 And inasmuch as the only essential divergence between the privilege taxes of Ohio and Illinois is the difference in rate, the court, by superimposing the Illinois deductions upon the Ohio rate could have effectuated this legislative purpose, and at the same time have fully complied with the terms of the retaliatory statute.

12. The decision would also appear to permit Ohio corporations whose entire Illinois business consists of reinsurance to operate in Illinois without payment of an Illinois tax.
13. OHIO GEN. CODE (Page, 1926) § 5436.
14. Id. §§ 5432, 5433.
15. Cochrane v. Bankers Life Co., 30 F. (2d) 918 (C. C. A. 8th, 1929); State v. American Insurance Co., 79 Ind. App. 88, 137 N. E. 338 (1922); Bankers Life Co. v. Richardson, 192 Cal. 113, 218 Pac. 696 (1923); Life & Casualty Insurance Co. of Tennessee v. Coleman, 233 Ky. 350, 25 S. W. (2d) 748 (1930); Pacific Mutual Life Insurance Co. v. State, 161 Wash. 135, 296 Pac. 813 (1931). Of course, the general rate applicable to foreign corporations is the minimum which will be applied.
16. Many other differences appear in the statutes of the various states respecting deductions: for example, as to deduction of losses, time for payment, credit for other types of tax. See cases cited in note 15, supra.
The New York standard fire insurance policy stipulates that the insurance company may, in lieu of payment, repair damaged property within a reasonable time, provided notice of its intention be given within thirty days after proof of loss. The standard mortgagee clause declares that loss under the policy shall be payable to the mortgagee as his interest may appear, and that the mortgagee's interest in the insurance shall not be invalidated by any act of the mortgagor. In *Savarese v. Ohio Farmers' Insurance Company* the New York Court of Appeals held that under a policy containing these provisions a mortgagor who repaired damaged property without the consent of either the insurance company or the mortgagee was not entitled to the insurance proceeds as against the mortgagee, where the repairs were completed before the expiration of the period within which the insurance company itself might have elected to repair. The court further held that the mortgagee's recovery was limited by the eighty per cent clause, which provides that the insurance company shall not be liable for a greater proportion of any loss than the sum insured bears to eighty per cent of the cash value of the property at the time of the loss.

Where a mortgagee separately insures his interest in the mortgaged property, upon payment of a loss to the mortgagee the insurance company becomes subrogated to an equivalent part of the mortgage debt. But where the mortgagor and mortgagee are insured by the same policy, payment of a loss to the mortgagor discharges the mortgage debt pro tanto. It is of no consequence that the mortgage security remains ample after loss to secure the mortgage debt; the security is reduced and hence the mortgagee is entitled to the insurance proceeds according to his contract with the insurer. If when payment of a loss is made to the mortgagee the mortgage debt is not yet due, the mortgagee may benefit from the loss. And it might be argued that the mortgagee is still entitled to interest on the entire debt until maturity, unless the mortgage provided for earlier payment at the mortgagor's option. In the principal case the court permits a mortgagee to reap an even greater benefit from a "loss." If in the exercise of its option to repair, the insurance company, rather than the mortgagor, had rebuilt the property, the mortgagee could not have recovered. While payment of the insurance to the mortgagee, of course, discharges the mortgage debt pro tanto, the mortgagee has the same security for the remainder of the debt that he formerly had for the entire obligation. The decision is consequently at some variance with the established doctrine that a contract for the insurance of property is a contract of indemnity only. However, it may be urged that the option to repair given the insurance company

1. 182 N. E. 665 (N. Y. 1932).
3. Hubbs, J., dissented on the ground that the mortgagee was entitled to the full amount of the loss.
4. Foster v. Van Reed, 70 N. Y. 19 (1877).
6. But if the value of the mortgaged property before loss was only equal to the mortgage debt, the mortgagee may ultimately suffer loss to the extent that the value of the property destroyed exceeds the amount of the insurance proceeds.
7. See VANCE, INSURANCE (2d ed. 1930) § 30.
under the policy excludes a similar option of the mortgagor. Further, the
court in the principal case called attention to Section 254 of the New York
Real Property Law, subdivision 4, which provides that a mortgagee at his
election may apply insurance proceeds toward the payment of the mortgage
or may pay them over to the mortgagor, for the repair of damaged buildings,
and reasoned that this provision excluded a similar choice of the mortgagor.
But it is arguable that if the provision is construed to be applicable prior to
the expiration of the period within which, under the policy, the insurance
company might elect to repair, then even the insurance company's option to
repair is rendered nugatory. A counter argument would be that even though
the statute is absolute in its terms, it may reasonably be construed to give
the mortgagee a choice only as against the mortgagor, and not as against the
insurer.

It must be noted, however, though the court makes no mention of the fact,
that the statute is only applicable to insurance proceeds “received” by the
mortgagee, and if literally construed merely affirms the mortgagee's rights
without the statute; hence the provision would not seem to be relevant in
determining to whom the insurance proceeds should be paid. If the statute be
construed to enlarge the mortgagee’s rights, an interesting question arises as to
the legal relations of the parties where a mortgagee wishes to turn over ins-
urance proceeds to the mortgagor for repairs but the mortgagor is unwilling to
repair.

The most substantial premise for the mortgagee's position in the principal
case is that the repairing of the damaged property by the mortgagor is an
“act” of the mortgagor, which, under the standard mortgagee clause, cannot
invalidate the mortgagee's interest in the insurance. On the other hand, it
may be contended that the mortgagee could not possibly have a right of action
against the insurance company until the expiration of the period within which
the company might elect to repair, that until then the mortgagee's interest in
the insurance proceeds was not to be determined, and that at the expiration of
this period in the principal case no loss to the mortgagee appeared. A narrow
question of construction of the mortgagee clause is thus presented.

If a right of action once vests in the mortgagee, it seems clearly unreasonable
to permit the right to be divested by the mortgagor by repairing the property
at any time before suit is brought. And if the repairs are only partially
completed by the mortgagor at the expiration of the period within which
the insurance company might elect to repair, it would seem that as a matter of
convenience the mortgagee should be held entitled to the entire amount of the
insurance. But in the situation presented by the principal case the awarding
of the insurance proceeds to the mortgagee will have the unfortunate effect
of requiring mortgagors separately to insure their interests in order to assure

8. Obviously, if the mortgagor repaired the property the insurer could
not exercise its option to repair. Moreover, the doctrine of expressio unius cat
exclusio alterius seems applicable.
10. See dissenting opinion of Lehman, J., at 670.
In re Moore, 6 Daly 541 (N. Y. 1876); and cf. Huey v. Ewell, 22 Tex. Civ.
App. 638, 55 S. W. 606 (1900); Ramsdell v. Insurance Co. of North America,
197 Wis. 136, 221 N. W. 654 (1928).
(Sup. Ct. 1931).
themselves of funds with which to repair damaged property. However, there is the equally practical objection in favor of the mortgagor that the awarding of the insurance proceeds to the mortgagor would often compel the mortgagor to litigate the sufficiency of the repairs. Mortgagees, often far away from the mortgaged property, could not be expected to supervise the mortgagor’s activities.

The standard coinsurance clause provides that the insurance company shall not be liable for a greater proportion of any loss than the sum insured bears to the total insurance on the property. But since under the standard mortgagee clause no act of the mortgagor can invalidate the mortgagee’s interest in the insurance, the procurement of additional insurance by the mortgagor for his separate benefit does not operate to diminish recovery by the mortgagor. Nor is the mortgagee’s recovery diminished where the mortgagor without the knowledge of the mortgagee has additional insurance on the property at the time the mortgagee’s interest is insured. In the principal case the mortgagee claimed the full amount of the loss on the ground that the eighty per cent clause, like the coinsurance clause, was inapplicable to mortgagees by reason of the standard mortgagee clause. He argued that if the provision affected mortgagees, a mortgagor, by making improvements on the mortgaged property before loss, would thereby diminish the mortgagee’s interest in the insurance, since under the eighty per cent clause the extent of recovery is diminished by an increase in the value of the property before loss. But it seems improbable that the parties to the contract ever contemplated that the insurance company should be liable for the full amount of a loss. Moreover, a mortgagee, who normally rejoices before loss when the mortgagor makes improvements on the mortgaged property, should not be heard to complain of the same improvements after loss. And the ostensible purpose of the eighty per cent clause, namely, to discourage negligence and incendiaryism by making the insured bear a portion of the loss, relates to the mortgagee as well as to the mortgagor. Hence the court’s rejection of the mortgagee’s argument seems correct.

13. Proof of loss under the policy must be made within sixty days after the fire, unless the insurance company agrees in writing to a longer period. Thereafter the company has thirty days in which to elect to repair. Hence, had the court reached a contrary result, mortgagors would have had ninety days within which to repair damaged property and thereby entitle themselves to the insurance proceeds.

14. This objection would seem even more substantial if the mortgagor were allowed recovery pro tanto for partial repairs.

15. Eddy v. London Assurance Corp., 143 N. Y. 311, 38 N. E. 307 (1894). But doubtless the mortgagee’s recovery would be diminished where the mortgagee, either separately or in conjunction with the mortgagor, procured additional insurance on his own interest.


REALIZATION OF TAXABLE INCOME BY CORPORATION'S PURCHASE OF ITS OWN DIVIDEND BONDS

In 1914 the taxpayer, a New York corporation, approved an appraisal of its assets which added $3,000,000 to its surplus account. Against this surplus the corporation issued a $2,000,000 bond dividend. In 1926 and 1927 some of the unmatured bonds were purchased by the corporation at less than their face value. These bonds were cancelled, and the difference between the purchase price and the face value was credited to surplus. The Board of Tax Appeals ruled that the amount of this difference did not constitute taxable income to the corporation, and on appeal its decision was affirmed.1

In the principal case the corporation by purchasing some of its bonds at less than their face value decreased its liabilities by the amount of the par value of the bonds purchased, decreased its assets by the amount of the cash paid for the bonds, and increased its surplus by the amount of the difference between the two.2 In United States v. Kirby Lumber Co.3 a corporation issued its bonds in return for their face value in cash and later in the same year repurchased some of them at less than their face value. The Supreme Court held that the amount of the difference constituted income. The court in the principal case distinguished the Kirby case on the ground that the bonds here involved were not issued in return for cash, but merely as a method of distributing surplus. But regardless of the purpose for which the bonds were issued, it would seem that by purchasing some of them at less than their face value the corporation did realize an actual gain, since assets in the amount of the purchase discount were released to the general uses of the taxpayer. Assets minus liabilities equal proprietorship, and it would seem to be immaterial to a solvent corporation whether proprietorship is increased by an increase in assets, as a result of an operating profit, or by a decrease in liabilities, as a result of the liquidation of a valid obligation at less than its face value.

The court in the principal case distinguished decisions involving the adjustment of tax returns for former years on the ground that here the obligation evidenced by the bonds had never been an expense item deductible from gross income. But in Western Maryland Ry. v. Commissioner4 a corporation that sold its bonds at a discount was held entitled to deduct each year from its gross income as interest the actual amount paid the bondholders plus an aliquot portion of the discount prorated over the life of the bonds.5 Hence if a corporation repurchases at a discount bonds issued for their face value in cash, it is evident that each year prior to the repurchase the corporation has deducted as interest the full amount paid the bondholders, whereas it should only be allowed to deduct that amount minus an aliquot portion of the discount at which the bonds were repurchased.6 Rather than disturb old tax returns, the Commissioner of Internal Revenue has chosen to regard the repurchase dis-

2. See Comment (1931) 40 YALE L. J. 960, 962 and n. 12.
3. 284 U. S. 1, 52 Sup. Ct. 4 (1931).
5. This method of amortization, of course, is not strictly accurate, but generally has been adopted for the sake of simplicity. HATFIELD, ACCOUNTING (1928) 230.
count as income. Accordingly, although the obligation evidenced by the bonds in the principal case was never an expense item deductible from gross income, it would seem that inquiry should be made as to whether the corporation, during the years the bonds were outstanding, had deducted interest payments on the bonds as an expense. If interest payments were so deducted, unquestionably the purchase discount should be regarded as income to the extent of the prior deductions.

**The American Tobacco Company Case—Some Jurisdictional Problems**

The directors of the American Tobacco Company, a New Jersey corporation doing a world-wide trade, with its "principal place of business" in New York city, advised the stockholders to ratify a general plan whereby 56,712 shares would be allotted to deserving employees in accordance with recommendations made by the president. Having obtained more than the two-thirds assent required by the New Jersey statute under which they purported to act, the allotments were made, and the president received 13,440 shares by transfer in trust, at a par value of $25. The market price was then $116. The plaintiff, a minority stockholder residing in New York, brought suit to enjoin the distribution to officers and subsequently the suit was removed to the Federal court for the Southern district of New York. The Supreme Court, three justices dissenting, and one not voting, decided that the district court could not take jurisdiction of the suit, since it involved the regulation of the internal affairs of a foreign corporation and depended for its settlement upon the effect to be given to statutes of the state of incorporation. The Court reversed the judgment of the Circuit Court of Appeals which had decided in favor of the company on the merits, and reinstated the original judgment dismissing the suit without prejudice.

The merits of this particular employee stock participation plan have been previously discussed in this Journal. It was assumed that if the Court disapproved of the transaction in substance, no untoward exercise of discretion would be involved by taking jurisdiction. Certainly, Mr. Justice Stone saw no jurisdictional difficulties, and in a vigorous dissent condemned the failure of the company's officers to disclose previous bonuses and credits to themselves, and the vagueness of the plan which concealed the now evident self-interest of the executives.

The jurisdictional issues cannot be determined by the exercise of logic. The old rule which gave local protection to the stockholder in a foreign corporation

8. For a fuller discussion of the treatment of bond premiums and bond discounts for income tax purposes see Comments, supra notes 2 and 6.
1. N. J. Stat. (1920) c. 175, § 1.
3. 60 F. (2d) 114 (C. C. A. 2d, 1932) per Manton, J. Judge Swan dissenting.
4. 60 F. (2d) 106 (S. D. N. Y. 1932).
5. Note (1933) 42 Yale L. J. 419.
6. 53 Sup. Ct. at 299, 304.
as to his individual rights, but denied the local remedies for invasions of his rights as a stockholder, is based upon a fictitious distinction. It was perhaps sufficient for times when a corporation transacted most of its business in the state of incorporation. But now it is admittedly the "inability of the court to do complete justice by its decree and not its incompetency to decide the questions involved that determines the exercise of its power." If the court can do no more than to make the matter res judicata for necessary enforcement by another court, it may as well refuse jurisdiction over a foreign corporation. On the other hand, where all the parties are before the court, where at least some business is done in the district of the local tribunal, and where the particular transaction occurred, in part at least, in the district of the local court, it is difficult to perceive what is lacking to make the decrees of the court effective.

Furthermore, if the requested relief is concerned with specific acts that, unlike receiverships, do not require the local court to examine the entire business of the foreign corporation, or to assume custody of all its assets, then jurisdiction may well be assumed. In the instant case, all parties are before the court; the company's principal place of business, books and records, all are in New York; several of its officers are New York citizens.

7. North State Copper Co. v. Field, 64 Md. 151, 20 Atl. 1039 (1885).


10. These elements were present in cases cited supra note 8, but, completely or in part, were absent where the court has refused jurisdiction. See, for example, Chicago Title & Trust Co. v. Newman, 187 Fed. 573 (C. C. A. 7th, 1911); Jackson v. Hooper, 75 N. J. Eq. 592, 75 Atl. 568 (1910); THOMPSON, CORPORATIONS (3d ed. 1927) §§ 6697-6699.

the plan involved the active cooperation of the New York Guaranty Trust Company; and the complaint bears no relation to the entire business of the company.\(^1\)

The further objections of the majority to deciding the effect of a state statute appear to be more dilatory than substantial, since the probable result of the dismissal, if the plaintiff continues, will be to bring the case again before the federal judiciary by way of the federal Court for the District of New Jersey.\(^2\) But the conduct of the directors of the American Tobacco Company in the instant case can be attacked apart from any consideration of the New Jersey statute unless it is said that a statute may condone a fraud. The separation of ownership from control\(^3\) demands that complete information be given to scattered stockholders on the occasions when they must make a decision on policy. In dealing with a corporation engaged in a world-wide business, the New York court is clearly able to enjoin benefits to corporate officers, as unreasonable compensation, or because of the secretive methods employed to secure the stockholders' ratification. Although the decision leaves the legal status of the plan undecided, the president of the American Tobacco Company has announced that he has given up his shares of the stock, and further suit may be unlikely.\(^4\)

**ALLOWANCE OF COSTS RECOVERED IN ACTION AGAINST INSOLVENT BANK**

The plaintiff filed his claim for the credit balance of his account with the superintendent of banks, liquidator of the Bank of the United States. Upon rejection of his claim, he sued the bank for his balance. The bank set up a counterclaim alleging that the plaintiff was indebted to it as indorser on two notes. The lower court sustained the bank's counterclaim and granted judgment to the plaintiff for the difference between his deposit balance and the defendant's counterclaim, together with costs. Liquidation dividends were paid to the plaintiff on the amount of his judgment, exclusive of costs, and the question on appeal was whether he was entitled to payment of costs in full or merely to regular liquidation dividends thereon. The New York Appellate Division held that the plaintiff was entitled to full payment of the costs awarded to him.\(^5\)

In the only other case found presenting substantially the same problem involved in the instant case, it was held that a judgment for costs in a claim contested by the liquidator of a bank should be paid in full.\(^6\) Costs recovered

---


against a receiver, or an administrator or executor of a deceased, are held entitled to priority of payment over claims of general creditors of the estate, and the same rule probably applies to situations involving the recovery of costs against trustees in bankruptcy and assignees for the benefit of creditors, although no authority for this proposition has been found. The application of these analogies, however, would be considerably restricted if the argument of the dissent in the instant case were adopted: that the bank, and not the liquidator, was the defendant in the suit by the depositor for his balance, and that the recovery of costs by the plaintiff resulted in a debt of the bank which is payable by the superintendent along with the claims of other general creditors. The cases involving the recovery of costs against a receiver or the personal representative of a deceased were thus distinguished on the ground that they are the only parties who may sue or be sued, whereas a superintendent of banks is merely a liquidating custodian not having such powers. The dissent concluded, therefore, that the judgment should not be divided, since “It constitutes, after all, but one indebtedness.” The application of this reasoning to a situation involving litigation of a small claim, however, may well be questioned, since a pro rata allowance for costs might result in the expenditure by the claimant of more than the actual amount of the recovered claim. And although it may be argued that payment of full costs would be prejudicial to the general creditors of the insolvent, there is no valid reason why the fund to which the creditors are entitled should not be subjected to payment in full of the costs of opposing a successful claim, especially where the claim was rejected in the first instance for the benefit of all the creditors.

3. Columbian Insurance Co. v. Stevens, 37 N. Y. 536 (1868) (costs recovered against receiver by successful defendant); Locke v. Covert, 42 Hun 484 (N. Y. 1886) (costs recovered against receiver by successful plaintiff).

4. Shields v. Sullivan, 3 Dem. Rep. 296 (N. Y. 1885) (costs recovered against administrator by successful plaintiff); In re Casey’s Estate, 6 N. Y. Supp. 608 (3d Dep’t 1889) (costs recovered against executor by successful defendant); In re Randell’s Estate, 2 Con. 29, 8 N. Y. Supp. 652 (Sur. Ct. 1889) (costs recovered against executrix by successful plaintiff); Matter of Mahoney, 37 Misc. 472, 75 N. Y. Supp. 1056 (Sur. Ct. 1902) (costs recovered against administratrix by successful defendant); In re Friedlander’s Estate, 160 App. Div. 475, 145 N. Y. Supp. 679 (1st Dep’t 1914) (costs recovered against executor by successful defendant). In Shute v. Shute, 5 Dem. Rep. 1 (N. Y. 1886), it was held that a judgment for costs recovered against the personal representative of a deceased are not entitled to priority over the general creditors of the estate. This decision, however, was expressly overruled in In re Randell’s Estate, supra.

5. In In re Carnegie Trust Co., supra note 2, the court said: “It is well settled that costs against executors, administrators, assignees for the benefit of creditors and receivers are payable out of the estate and have priority over the claims of general creditors.” None of the cases cited for this proposition applied to situations involving assignees for the benefit of creditors, and no authority, other than this dictum, has been found.

6. Two judges dissented.

7. See note 3, supra.

8. See note 4, supra.

A, who was president of both the plaintiff and the X corporation, was empowered to draw on the checking account which the X corporation carried with the defendant bank. He deposited to the credit of the X corporation a check payable to the plaintiff corporation and endorsed in blank by A and his son. The son, who held no position in the plaintiff corporation, had been persuaded to countersign falsely as secretary. Subsequently, A diverted the proceeds to his own use. The jury found that A had no authority to endorse without restriction, but that the bank was not put on notice. Nevertheless, the bank was held liable in conversion. By this decision, the New York Court of Appeals reaffirms its belief that checks payable to a corporation are normally deposited in the account of the payee corporation, that payments by check of corporation debts are normally made with checks drawn on its own account and that a departure from this practice should put takers upon notice. The opinion, however, is phrased in terms of agency and ignored the conflict in the jury findings. The Court of Appeals accepted the first finding and shaped it to conform with its own belief that customary business practice did not give A actual authority as president to deposit in his own account, a check payable to the corporation. It further stated that the signature of A's son precluded reliance upon apparent authority in A alone.

The established rules of agency supply the outline for the opinion. A principal is not liable for an unauthorized issue of a negotiable instrument, where

1. "Do you find from the evidence that the defendant bank was required in this particular transaction to make inquiries with respect to the indorsement appearing on said check." To this the jury answered: "No." Record of case on appeal, p. 18. It is not clear that the question is one of fact, properly put to the jury.

2. Wen Kroy Realty Co. v. Public National Bank, 260 N. Y. 84, 183 N. E. 73 (1932). A demurrer was sustained to the original complaint which went on the theory that the bank was liable because it knew the president could draw on the account of X corporation. Same, N. Y. L. J. April 27, 1928. At trial on the amended complaint, the trial court ruled for the bank, but the appellate division reversed. 234 App. Div. 461, 255 N. Y. Supp. 1 (1st Dep't 1932).


4. See Note (1932) 46 HARV. L. REV. 516: "It is difficult to regard the representation of the non-existent agency of the son as notice of the father's actual lack of authority." But see infra.
any substantial departure by the agent from the ordinary methods of conducting business is sufficient warning of lack of authorization, actual or apparent.\textsuperscript{5} The New York courts, however, have refrained from imposing harsh and impracticable burdens upon bankers.\textsuperscript{6} There is, of course, no reason why the bank should not be held, where it appears from the face of a negotiable instrument, which the bank takes in satisfaction of its claim against the agent, that the instrument belongs to the principal.\textsuperscript{7} Where, however, the bank is not a creditor but merely accepts a check for deposit, the transaction itself must give the bank clear notice not only that the instrument belongs to the principal but also that the proceeds have been or will be diverted to satisfy personal debts of the agent.\textsuperscript{8} Accordingly, a bank is not liable where the corporation's agent deposits in his own account a check drawn to his own order upon corporate funds, for it is likely that a corporation would discharge a debt due the agent by check.\textsuperscript{9} Nor is it liable where an executor deposits in his personal account a check drawn on or payable to the trust estate.\textsuperscript{10} Such a transaction gives notice that the proceeds belong to the trust estate, but executors may pay trust debts by personal checks. A second transaction in which the executor uses the proceeds of such deposits to pay a personal obligation to the bank is necessary before the bank can be said to have notice of the conversion.\textsuperscript{11} But the transaction in the instant case was in itself considered sufficiently inconsistent with the usual business practice to put the bank on notice.\textsuperscript{12} So confirmed is the

\begin{notes}
\item[8] By building up an account with transfers from the principal's funds, the agent obviously can satisfy his private debts by issuing checks which give no indication that the funds belong to the principal.
\item[9] Havana Rr. Co. v. Knickerbocker Trust Co., supra note 6. There is a Massachusetts decision holding that as to such a check, not deposited with a bank, but given in payment of a private debt of the agent, the taker is not put on notice. Fillebrown v. Hayward, 190 Mass. 472, 77 N. E. 45 (1906). But in Schmitt v. Potter Title Trust Co., 61 Pa. Sup. Ct. 301 (1915), and Bank v. Gillette, 52 Okl. 341, 152 Pac. 1084 (1915), the bank was held where the checks were drawn payable to the agent. In Rochester Co. v. Paviour, 164 N. Y. 281, 58 N. E. 114 (1900), the personal creditor was held liable for conversion where he took a check drawn by the agent payable to the creditor.
\item[12] The New York Court has suggested that even if the agent had authority to endorse generally so that his signature would be valid under § 42 of the Negotiable Instruments Law still it might be that the form of the check indicated a method of doing business so "far out of harmony with the custom of corporations" as to warn the defendant. S. S. Specialty Co. v. Corn Exchange Bank, supra note 2.
\end{notes}
New York court in its belief that a corporation normally deposits in its own account checks of which it is the payee that where the check is restrictively endorsed by rubber stamp, a deposit in any other account will put the bank on notice. It is not necessary, as in the instant case, that it be an account over which the agent has drawing power. And it has been held that a similar fixed usage with respect to checks prevails among unincorporated enterprises.

If it be true that there is a single prevailing channel for checks payable to a corporation, then the result reached in the instant case is justified by policy. Since notice of the diversion by the agent was apparent from the transaction, and especially from the face of the check, the imposition of liability upon the bank was necessary to establish even a minimum standard of care in preventing such diversions. A departure from a rigid norm is a gross departure. The norm is geared to ordinary honesty and a gross irregularity warns of dishonesty. Perhaps checks payable to a corporation do not follow as straight a course as the instant case suggests, but it is useless to direct attention to anything save the validity of the belief that they do. At least, no amount of discussion of actual and apparent authority and no analogies to executors and trustees will disprove that belief.

---

**Reimbursement by Remote Grantee of Original Grantor-Mortgagor for Payment of Judgment**

In *Harvey v. Lowry* the plaintiff, a judgment debtor, sold his interest in certain land which was incumbered by a judgment lien, the grantee buying subject to the incumbrance but making no contract to pay the judgment debt. The grantee sold his interest to a second grantee under the same conditions. Thereupon execution was levied on the land, and it was sold to the judgment creditor for an amount less than that required to satisfy the claim. The second grantee sold his equity of redemption to a third grantee, the defendant in the principal case, who contracted as part of the purchase price to satisfy the judgment debt in full. The defendant redeemed the land, and, without further payment, obtained from the judgment creditor a release of all claims.

---


15. See Merrill, *Bankers Liability for Deposits of Fiduciary* (1927) 40 HARV. L. REV. 1077, favoring liability even in case of executors and trustees. For the opposite point of view, see Scott, *Participation in a Breach of Trust* (1921) 34 HARV. L. REV. 454; Note (1926) 34 YALE L. J. 854.


17. *Supra*, notes 4 and 15.

1. 183 N. E. 309 (Ind. 1932).
against the property. Notwithstanding this release, the judgment creditor then recovered from the plaintiff, the original debtor-grantor, the balance of the judgment debt. To reimburse himself for payment of the balance, the plaintiff brought this action upon the defendant's contract with the second grantee to satisfy the judgment, contending that he was a third party beneficiary of the contract, or, in the alternative, that he was subrogated to the rights of the judgment creditor thereunder. The court, in affirming a judgment for the defendant, refused to grant the reimbursement.

It further concluded that although the plaintiff might have derived an incidental benefit from the performance of the defendant's promise to satisfy the judgment, nevertheless, since the plaintiff was not contemplated as the beneficiary of that promise, he could not recover from the defendant as a third party beneficiary.

The plaintiff must have been a surety for the balance of the judgment debt in order to have a right of subrogation to the rights of the judgment creditor. It is frequently said that a person is a surety only when there is a fund or other person primarily liable for the debt. Property which, as in the principal case, is subject to resale to satisfy the balance of a debt, is considered such a fund primarily responsible, and all prior grantors are sureties for the liability of that fund. Therefore, the plaintiff as a surety in the principal case, would have recourse by subrogation to the land for reimbursement. But the plaintiff was precluded from recovery upon this principle, inasmuch as the judgment creditor had released the defendant of all claims against the property.

A right of the plaintiff against the defendant might have been predicated upon subrogation to the creditor's right against the defendant on his contract to satisfy the judgment. But again, in order to be subrogated to this right the plaintiff must have been a surety, and the defendant must have been primarily liable for the balance of the judgment debt. If the first and second grantees of the land had contracted to satisfy the judgment debt, the defendant as last grantee would have been primarily liable for the debt, and all prior grantors, including the plaintiff, would have been sureties. This is for the reason that each grantor-promisee would have had a right of action against his grantee, and the last grantee would ultimately have had to pay the debt. In such a situation the plaintiff as surety would be subrogated to the rights of the creditor against the last grantee. But in the principal case, the court held that since there was no chain of personal liability running from the plaintiff to the defendant as last grantee, the defendant was not primarily

3. SHELDON, SUBROGATION (2d ed. 1893) § 3.
4. STEARNS, SURETYSHIP (3d ed. 1922) § 5.
5. IND. ANN. STAT. (Burns, 1926) § 834.
7. STEARNS, op. cit. supra note 4, § 4.
8. It is doubtful whether the judgment against the plaintiff in favor of the creditor for the balance of the judgment debt was correct; for if the holder of a lien releases the land after a conveyance, he thereby releases the liability of the grantor-debtor. Townsend Savings Bank v. Munson, 47 Conn. 390 (1879); Paine v. Jones, 76 N. Y. 274 (1879).
9. See note 3, supra.
liable, and the plaintiff could not be subrogated as surety to the creditor's rights on the defendant's contract.

It is well settled that the holder of a judgment lien can sue a grantee who has promised his grantor to satisfy the judgment; and in most jurisdictions this is true even though the grantor was not personally obligated to the judgment creditor. The right of the judgment creditor is founded on the rights of third party beneficiaries. But it is doubtful whether a remote grantor who was not the contemplated beneficiary of the grantee's promise and whose immediate grantee did not personally assume the debt, could be substituted as the holder of the right of the creditor against the last grantee. This situation appears to have arisen for the first time in the instant case, and the court declined to extend the rights of the creditor to such a remote grantor. Before the balance of the original judgment debt was paid to the creditor, both the plaintiff and defendant in this action were obligated to pay it on different contracts, and the creditor could have collected from either one. In such a situation it would seem equitable that they each pay a share of the obligation; but whether the courts will recognize this equity remains for the future to determine.

CONTINUATION OF BANK STOCKHOLDER'S LIABILITY AFTER TRANSFER

Double liability statutes are ordinarily interpreted as allowing bank stockholders to insulate themselves from individual liability by transferring their stock. The statutory liability is considered a charge or lien on each share of stock, attaching the moment the debt is contracted by the bank, and following the stock into the hands of its successive owners. On this theory, only the stockholders at the time of the bank's suspension assume responsibility for its debts and obligations, regardless of the time they were incurred.

A recent Illinois case is significant in its departure from the prevailing view, and in its extension of double liability to former stockholders of an insolvent state bank. The defendants in that action had formerly been stockholders but had disposed of their shares in good faith two days to nine years prior to the bank's insolvency. Despite the transfer, all were assessed sums equal to the par value of their former stock holdings. The relevant sections of the state constitution and banking law imposed an individual responsibility upon every owner of stock "for all liabilities accruing while he or she..."
remains such stockholder. The court construed these provisions as imposing liability upon all successive holders of the same shares of stock for deposits made during their respective periods of ownership. The view that the statutory liability attaches to the stock was expressly repudiated, and a transfer was declared inoperative to release the vendor from personal liability. As a corollary, the vendee could not be assessed for debts incurred before he became a shareholder. And since the constitution suggested no method of terminating this successive personal liability, the court took the position that the several liabilities upon a single share of stock may aggregate the product of the par value of that share and the total number of its consecutive owners.

Decisions denying insulation from liability through a transfer of stock have been rationalized in several ways. A few courts have regarded the statutory liability of shareholders in corporations as comparable to the personal responsibility of partners for the debts of the partnership, and applied the familiar doctrine that the withdrawal of a partner does not discharge his individual responsibility for the existing obligations of the firm. Others have sought to prevent stockholders suspicious of the bank's impending insolvency from transferring their shares to financially irresponsible parties. A further consideration has been solicitude for those who became stockholders during the closing days of the bank, and who would incur a double liability in addition to the loss of their initial investment. Finally, a few cases have been decided on the assumption that creditors entrust their funds to the bank, relying on the security of the existing stockholders, so that to permit a transfer to operate as a release from liability would be fraudulent as to depositors. These contingencies are provided for in most jurisdictions by a statutory extension of liability for periods of sixty days to one year after a transfer, a remedy which seems preferable to the indiscriminate assessment of prior stockholders.


8. For a case in accord with this view, see Morrisey v. Williams, 74 W. Va 636, 639, 82 S. E. 509, 510 (1914). In Ohio, the transferor is liable but may seek indemnity from the transferee. Brown v. Hitchcock, 36 Ohio St. 667 (1881); Harpold v. Stobart, 46 Ohio St. 397, 21 N. E. 637 (1889).


10. This position is extreme and has no support even in jurisdictions where the transferor is not released from liability. Pyles v. Carney, 85 W. Va. 159, 101 S. E. 174 (1919); cf. Thebus v. Smiley, supra note 2; Williams v. Hanna, 40 Ind. 535 (1872); Harper v. Carroll, 66 Minn. 487, 69 N. W. 610 (1896).


15. The Federal statute is typical: "The stockholders . . . who shall have transferred their shares . . . within sixty days next before the date of the
The significant feature of the instant decision is the increased protection theoretically accorded bank depositors. However, so many practical difficulties are apparent in collecting assessments from prior stockholders that it is questionable whether the Illinois court has devised a workable rule for giving depositors substantial security. For the large number of stockholders, the frequent transfers of stock, the death or insolvency of parties, and the removal of former stockholders from the jurisdiction may well make the recovery of a substantial amount from former shareholders highly speculative. And since each creditor may look only to those who were shareholders at the time his deposit was made, depositors are not treated equally since less security is afforded to early depositors. Moreover, with the numerous deposits and withdrawals in active accounts, complications are certain to arise in computing what part of such indebtedness existing at the time of his transfer should be assessed against the transferee. An additional factor, admittedly conjectural, is the extent to which the principal decision will deter prudent investors from purchasing bank stock, where they remain responsible for future mismanagement of the bank after the transfer of all ownership, interest, and control.

The Supreme Court of Washington, in construing almost identical language in its state constitution, avoided the conclusions reached in the instant case. The Washington court, after recognizing the ambiguity of the words “accruing while they remain such shareholders,” declared that debts and engagements of a bank do not accrue until the obligation to perform arises. Since the bank would normally meet its obligations as they matured, the only debts for which shareholders would be responsible are those accruing upon the bank’s insolvency. Therefore, the court concluded, only present stockholders could be subjected to the statutory assessments. By a similar construction of its own constitution, the Illinois court might have avoided the scheme of double liability enforced by the instant decision.

failure of such association to meet its obligations. . . . shall be liable to the same extent as if they had made no such transfer, to the extent that the subsequent transferee fails to meet such liability.” 38 Stat. 273 (1913), 12 U. S. C. § 64 (1926). There would be no liability, however, for obligations incurred by the bank after the transfer. Mobley v. Phinizy, 172 Ga. 330, 157 S. E. 182 (1931); Bank of Dassel v. March, 183 Minn. 127, 235 N. W. 914 (1931). The Supreme Court has relieved the transferee of liability to subsequent creditors even where the transfer was to a financially irresponsible person. McDonald v. Dewey, 202 U. S. 510 (1906); but cf. Newton v. Bennett, 159 Ga. 426, 126 S. E. 242 (1924); Note (1932) 41 YALE L. J. 593, 596.


17. This inequality is heightened in Illinois, since creditors may individually enforce the stockholders liability. Golden v. Cervenka, 278 Ill. 409, 116 N. E. 273 (1917); see Note (1932) 27 Ill. L. Rev. 185.


20. Duke v. Johnson, 123 Wash. 43, 211 Pac. 710 (1923), overruling Shuoy v. Holmes, 21 Wash. 223, 57 Pac. 818 (1899) and Fremont State Bank v. Vincent, 112 Wash. 493, 192 Pac. 976 (1920) which are in accord with the instant case. Iowa, with the same type of constitutional provision, is in accord with the Washington decision. Andrew v. Commercial State Bank, 206 Iowa 1070, 221 N. W. 809 (1928); Andrew v. People’s State Bank, 211 Iowa 649, 234 N. W. 542 (1931).
Some months ago the Circuit Court of Appeals of the Fourth Circuit, in the case of Sorrells v. United States,\(^1\) reversed its former position with regard to the defense of entrapment in criminal prosecutions, and held that instigation of violation of the National Prohibition Act through persuasion or other inducement by government officers could not be pleaded as a defense. The extreme position taken by the court in this decision and the lack of uniformity in attitude among federal courts toward the defense of entrapment—due to repeated refusals by the Supreme Court to accept certiorari in such cases—were commented upon at the time in a note on this case,\(^2\) to which reference is made for the facts in the case and a discussion of the problems involved. Here it is to be added that the Supreme Court has reversed Sorrells v. United States,\(^3\) and has established the validity of this defense.

The majority opinion of the Supreme Court placed the decision on the ground that, upon reasonable construction, the criminal offenses denounced by the National Prohibition Act do not include such acts as are instigated by government officials. The case was accordingly remanded for further proceedings. Three justices,\(^4\) two of whom had dissented in the Olmstead case,\(^5\) found some difficulty in reading into the statute this exclusion of cases involving entrapment, but, in the spirit of that former dissent,\(^6\) preferred to ground the reversal upon the broad public policy that courts of the United States should be closed to the trial of a crime instigated by its own agents. They therefore recommended, in a separate opinion, that the indictment should be quashed and the case dismissed.

At first glance, sufficient reason for a minority opinion does not appear. Conceptually, it is true, the minority might well have disagreed with the majority's somewhat strained construction of the statute involved. But more pragmatic reasons for the position of the minority may be discerned. Possibly they wished to announce a position generally condemnatory of entrapment and not restricted to the particular situation. Moreover, certain procedural implications of the two opposing positions are of considerable significance. Under the majority view, evidence of entrapment must be introduced under the plea to the general issue, and the fact of entrapment becomes a matter which the jury must determine, and finally dispose of, as an element of its finding of “guilty” or “not guilty.” Under the minority view, however,

---

1. 57 F. (2d) 973 (C. C. A. 4th, 1932).
2. 41 YALE L. J. 1249 (1932).
3. 53 Sup. Ct. 210 (1932). Mr. Justice McReynolds was of the opinion that the judgment below should be affirmed.
4. Mr. Justice Roberts, Mr. Justice Brandeis, Mr. Justice Stone.
5. Olmstead v. United States, 277 U. S. 438 (1928). In this case evidence for the government, which had been obtained by government agents through “wire-tapping,” in violation of the laws of the state where it occurred, was admitted in a criminal prosecution, over the dissents of four justices (Mr. Justice Holmes, Mr. Justice Butler, Mr. Justice Brandeis, Mr. Justice Stone). One of these four, Mr. Justice Butler, voted with the majority in the instant case.
6. The precise questions presented in the two cases are quite distinct. The objection in the dissenting opinions that the government should not be permitted to come into court with unclean hands is, in this broad aspect, essentially the same in both.
the issue of entrapment is a matter for the determination of the court, at any time and in any manner the question may be raised; and upon a finding of entrapment, before or after sentence, upon petition for a writ of habeas corpus, or even after tender of a plea of guilty, the indictment must be quashed and the case dismissed.

7. In case of doubt as to the facts the court may in any case submit the issue of entrapment to the jury for advice. See principal case, supra note 3, at 218; Jarl v. United States, 19 F. (2d) 891 (C. C. A. 8th, 1927).

8. Principal case, supra note 3, at 218.


12. It is to be noted also that if the decision be based upon the ground of public policy as in the dissent, and, in the words of Mr. Justice Roberts, "the protection of the purity of its own temple belongs only to the court," then not only was the defense not created by the legislature, but furthermore the legislature may not repeal it.