FEDERAL VENUE REQUIREMENTS FOR FOREIGN CORPORATIONS*

The gradual extension of the jurisdiction of federal courts over foreign corporations has been a process of adjusting outmoded juristic stereotypes to the pragmatic need of exposing these business units to suit. The original rule in diversity of citizenship cases, that a corporation could sue or be sued only when all of its stockholders were citizens of the state of incorporation, raised almost insuperable barriers to federal jurisdiction. A further obstacle was Chief Justice Taney's precedential dogma of the non-existence of a corporation outside the state of its creation, which, if logically applied, would have precluded personal judgments against the corporation in other states. In view of the vast amount of business transacted outside the state of incorporation, such immunity from suit was patently infeasible. Consequently, the federal courts took cognizance of suits involving foreign corporations, resorting to a series of fictions that subordinated logic and even fact to necessity. More than half a century from the enactment of the first Judiciary Act, the Supreme Court finally held that, for purposes of jurisdiction in diversity of citizenship cases, a corporation was conclusively presumed to be composed only of citizens of the state of its incorporation. In order to establish personal jurisdiction over foreign corporations in the states where they were doing business, several theories designed to secure effective service of process—"consent," "presence," "submission," "reasonable regulation"—have been employed. But a court possessing the requisite jurisdiction over subject


1. An excellent general discussion of the background and development of judicial treatment of foreign corporations is found in HENDERSON, THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW (1918).

2. Bank of the United States v. Deveaux, 5 Cranch. 61 (U. S. 1809). In 1840, the Supreme Court held that in diversity suits involving corporations, all the incorporators must be citizens of states different from that of the opposing litigant. Commercial & Railroad Bank of Vicksburg v. Slocomb, 14 Pet. 60 (U. S. 1840).

3. "It is very true that a corporation can have no legal existence out of the boundaries of the sovereignty by which it is created . . . It must dwell in the place of its creation, and cannot migrate to another sovereignty." Bank of Augusta v. Earle, 13 Pet. 519, 588 (U. S. 1839).


5. 1 Stat. 73 (1789).


7. The fictions developed to extend the jurisdiction of federal courts over foreign corporations are the same as those used for the state courts. For extensive discussion of
matter and persons is not necessarily the proper forum for the action. Since venue must also be satisfied, a defendant may demand that the action be brought in the appropriate district. By taking advantage of this venue privilege, a foreign corporation, until recently, could often take refuge from the federal courts.  

The federal venue statute of 1875 provided that, in all federal actions, a defendant could be sued only in a district “whereof he is an inhabitant or where he shall be found.” Under this act, the Supreme Court held in Ex parte Schollenberger that a foreign corporation which appointed an agent for service of process according to the law of the state in which it was doing business was suable in the federal courts. The accepted rationale of this case was that, by appointing an agent, the corporation consented to be “found,” thereby waiving its venue privilege. But in 1887 the statute was changed so as to eliminate the “found” clause. It was provided that an action should be brought only in the district whereof the defendant was an inhabitant, except that actions based solely on diversity of citizenship should be brought “only in the district of the residence of either the plaintiff or the defendant.”  

It was soon established, for purposes of venue, that a corporation was a resident or inhabitant only of the state in which it was incorporated. In the various theories, see Henderson, op. cit. supra note 1, at 77-100; Beale, The Conflict of Laws, 1886-1896 (1937) 50 Harv. L. Rev. 559, 593; Bullington, Jurisdiction Over Foreign Corporations (1928) 6 N. C. L. Rev. 147; Cahill, Jurisdiction Over Foreign Corporations and Individuals Who Carry on Business Within the Territory (1917) 30 Harv. L. Rev. 676; Fead, Jurisdiction over Foreign Corporations (1925) 24 Mich. L. Rev. 633; Scott, Jurisdiction over Non-Residents Doing Business Within the State (1919) 32 Harv. L. Rev. 871. Some of the problems peculiar to federal courts are discussed in Comment, Federal Jurisdiction Over Foreign Corporations (1935) 35 Col. L. Rev. 591.

8. Venue, as distinguished from jurisdiction, is not a matter of the court’s power to deal with controversies but simply relates to the geographical place of trial. It is a personal privilege of the defendant and can be waived either expressly or impliedly. General Inv. Co. v. Lake Shore Ry., 260 U. S. 261 (1922); Lee v. Chesapeake & O. Ry., 260 U. S. 653 (1922); see Doble, Venue in Civil Cases in the United States District Court (1925) 35 Yale L. J. 129; Foster, Place of Trial in Civil Actions (1930) 43 Harv. L. Rev. 1217.

9. 18 Stat. 470 (1875). (Italics supplied). This provision was the same as § 11 of the original Judiciary Act, 1 Stat. 79 (1879).

10. 96 U. S. 399 (1877).


12. 24 Stat. 552 (1887), as corrected by 25 Stat. 433 (1888), 28 U. S. C. § 112 (1934). The venue statute does not apply to alien corporations, which can bring suit only in the district of the defendant’s residence, but can be sued wherever found. Barrow Steamship Co. v. Kane, 170 U. S. 100 (1898); In re Hohorst, 150 U. S. 653 (1893).

13. Shaw v. Quincy Mining Co., 145 U. S. 444 (1892); In re Keasbey & Mattison Co., 160 U. S. 211 (1895); Seaboard Rice Milling Co v. Chicago, R. I. & P. Ry., 270 U. S. 363 (1926); other cases cited in N e i r b o C o. et al. v. Bethlehem Shipbuilding Corp., 103 F. (2d) 765, 767 (C. C. A. 2d, 1939). The Shaw case established that “citizen,” “inhabitant” and “resident” are used synonymously in the venue statute.
the event that there were two or more districts in one state, the corporation was considered a resident only of the district in which it had its principal office. Consequently, the doing of business within a state other than that of incorporation, regardless of the volume of operations, did not satisfy the requirements for residence. It likewise seemed established by *Southern Pacific Company v. Denton* that, in view of the elimination of the "found" clause in the new statute, the appointment of an agent for service of process was not to be construed as a waiver of venue or a consent to be sued in the federal courts.

The result of these decisions was to confer upon foreign corporations a discriminatory privilege to determine the forum for their litigation. If an action based on a federal question was brought against the corporation in any district court of the state in which it was merely doing business, the defendant corporation could have the action dismissed for improper venue on the ground that it was not an inhabitant of the state. The foreign corporation could likewise assert its venue privilege in diversity of citizenship suits brought by non-residents in the state of its activities, since neither the corporation nor the plaintiff was resident there. Although a plaintiff could properly bring a diversity suit in the district of his residence against a foreign corporation doing business in that district, he was effectively checked — at least, until the adoption of the Federal Rules of Civil Procedure in 1938 — if he tried to sue a corporation doing business in a different district of the same state. Inasmuch as process could not run outside the bounds of the district, he was unable to get service on the corporation through his own district court. If he went out of his district to sue where the corporation was doing business, he could get service of process, but he might be tripped on venue.

This dilemma of the resident plaintiff in diversity cases was finally solved by Rule 4(f) of the new Federal Rules. The provision for service of process

15. 146 U. S. 202 (1892). In this case, a citizen of the Eastern District of Texas sued a Kentucky corporation in the Western District of Texas for negligence. The corporation was doing business in the Western District and had appointed an agent for service of process according to a state law which also required foreign corporations not to resort to the federal courts. Although holding the statute unconstitutional because of the latter provision, the Supreme Court went on to interpret the extent of the corporation's agreement. In ruling that there was no waiver of venue by appointment of the agent, the Court distinguished the *Schollenberger* case on the basis of the change in statute. This ruling was made an alternative ground of decision in the case. See McLean v. Mississippi, 96 F. (2d) 741, 744 (C. C. A. 5th, 1938), cert. denied, 305 U. S. 623 (1938).
“anywhere within the territorial limits of the state in which the district court” was held enabled him to bring the action in his own district, and still get service over the corporation doing business in another district.9 The other venue barriers to diversity suits brought by non-residents and to federal question suits, however, could not be hurdled. Consequently, the defendant corporation had its choice between the state and federal courts. If the action was brought in the state court, it enjoyed the advantage of removal to a federal tribunal. If the action was started in a federal court, the corporation could of course waive venue at will and remain there.21 But by a timely claim of privilege it could force the plaintiff either to sue in the state court or else suffer the inconvenience of instituting a suit in the district court of the state of incorporation.22

In a recent decision,23 a divided Supreme Court checked this discriminatory power of foreign corporations to select their place of trial.24 A New Jersey stockholder brought an action against a New York corporation in the Federal District Court for the Southern District of New York to restrain the carrying out of a contract to sell assets to Bethlehem Shipbuilding Corp., Ltd. Upon the court’s refusal to enjoin, plaintiff filed an amended and supplemental bill asking that Bethlehem, a Delaware corporation doing business and having an appointed agent for service in the Southern District of New York, be joined as a party defendant. Jurisdiction was based upon diversity of citizenship. Bethlehem made a special appearance to quash service on the ground of improper venue under Section 51 of the Judicial Code,23 which, for purposes of this suit,26 is similar to the 1887 venue statute. The district court

20. See Moore's Federal Practice (1938) 360 et seq.
21. See note 8 supra. The foreign corporation, as a non-resident, has always enjoyed the privilege of removal to the federal courts. The removal operates as a waiver of the venue privilege. General Inv. Co. v. Lake Shore Ry., 260 U. S. 261 (1922). In Lee v. Chesapeake & O. Ry., 260 U. S. 653 (1922), removal was allowed even though the plaintiff, as well as the corporate defendant, was a non-resident of the district.
22. As a result many cases involving a federal question were doubtless kept out of the federal courts.
24. The power to object to venue was doubtless an aid in escaping some suits on the basis of the statute of limitations. Similarly, a corporation which had asserted its venue privilege in a federal court and subsequently been sued on the same action in a state court, was probably not estopped from removing to the same district court to which it had previously objected.
25. Venue privilege may now be asserted by a simple motion to dismiss under Rule 12(b) of the Federal Rules of Civil Procedure.
26. The following amendment was added to §51 in 1936: “... except that suit by a stockholder on behalf of a corporation may be brought in any district in which suit against the defendant or defendants in such stockholders' action, other than said corporation, might have been brought by such corporation and process in such cases may be served upon such corporation in any district wherein such corporation resides or may be found.” 49 Stat. 1213 (1936), 28 U. S. C. §112 (Supp. 1933).

If the present action were considered such a derivative action, it could clearly have been disposed of solely by means of this amendment. Plaintiff stockholders had joined their corporation, United Shipyards, Inc., as party defendant in their suit brought in the
granted the motion, and the Second Circuit Court of Appeals affirmed in an opinion that carefully restated existing law. Taking certiorari because of a conflict between the views of this court and those of the Tenth Circuit, the Supreme Court reversed the holding below. Mr. Justice Frankfurter, while accepting the doctrine that a corporation is a resident only of the state of its incorporation, held for the majority that Bethlehem had waived its venue privilege and consented to be sued in the Southern District of New York by its appointment of the statutory agent to receive process. This decision effectively overrules the holding of the Supreme Court in Southern Pacific Company v. Denton, which had been followed almost uniformly by the lower federal courts. At the same time, it revives the old Schollenberger case as a precedent for venue actions under the present statute, but reinterprets the rationale of that case to be that appointment of a statutory agent constitutes a consent to be sued, not merely a consent to be found.

This judicial curb of privilege was evidently motivated by a desire to realign the policy behind the venue statute with the actual position of a Southern District of New York. Since United is a New York corporation with its principal office in the Southern District, it could properly lay venue in that district in a diversity suit against Bethlehem. Therefore the plaintiff stockholders could properly sue Bethlehem in the Southern District, regardless of considerations of residence or waiver. Neither the circuit court nor Supreme Court mentions this amendment in its statement of § 51 or treatment of the problem. The only reference to it in briefs of counsel is a footnote on page 2 of the circuit court brief of counsel for appellee Bethlehem, which simply states that this is not a derivative suit, because of failure to comply with Equity Rule 27 or Rule 23(b) of the Federal Rules, and because the essential prayers are for personal relief. But a contrary argument could have been made on the basis of the complaint and of previous cases, if counsel were desirous of treating this as a derivative suit. See Di Tomasso v. Loverro, 293 N. Y. Supp. 912 (2d Dep't 1937), aff'd without opinion, 276 N. Y. 551, 12 N. E. (2d) 570 (1937); cf. Keenan v. Eshleman, 2 A. (2d) 904 (Del. 1938). See Moore's Federal Practice (1938) 2246-2276, 2301-2303.


29. Whether such surrender of a personal immunity be conceived negatively as a waiver or positively as a consent to be sued, is merely an expression of literary preference.” Neirbo Co. et al. v. Bethlehem Shipbuilding Corp., Ltd., 60 Sup. Ct. 153, 155 (U. S. 1939).

30. 146 U. S. 202 (1892); see note 15 supra.


"foreign" corporation. The purpose of Section 51 is "to save defendants from inconveniences to which they might be subjected if they could be compelled to answer in any district, or wherever found." When applied to private individuals, the residence requirements supply a reasonable rule of thumb. But in the case of corporate entities which are resident by legal concept in one state, yet "localized" for all practical purposes in the state or states of their business operations, convenience can scarcely be correlated with residence. The effect of the pre-Neirbo rule was usually to provide a dodge for the corporation rather than to insure an appropriate place for trial. For an organization such as Bethlehem, formally incorporated in Delaware but doing business and carrying out most of its corporate functions in the Southern District of New York, it would seem that, ideally, venue should be laid in New York. There is, of course, no grave public policy requiring that such substantive legal problems as are involved in the instant action be settled in the federal courts. But, inasmuch as the courts do have diversity jurisdiction, the majority clearly reached an equitable result.

It is interesting to note that, whereas previous proposals to strip foreign corporations of excessive privileges in the federal courts have sought to limit jurisdiction, the Neirbo case opens the door to more suits against such corporations in these tribunals. The decision, even though stemming from an action based solely on diversity, is equally applicable to those actions involving a federal question which formerly, under Section 51, could be brought only in the district of the defendant's residence. Likewise, it might well extend to suits arising under the special venue statutes which are designedly less restrictive than Section 51. For example, a patent infringement suit can be brought in the district of the defendant's residence, or in

34. The power of a foreign corporation to take its ordinary litigation to the federal courts on diversity grounds, although carrying on the bulk of its business within the state and enjoying substantially the equal protection of the laws, has been a constant source of irritation to the local citizenry. Premised upon the unfairness of such a privilege, several abortive attempts were made by the House of Representatives to close the courts to diversity suits between foreign corporations and citizens of the states in which they were doing business. See discussion of the Culberson Bills in Frankfurter and Landis, The Business of the Supreme Court (1927) 89 et seq. A recent attempt to limit federal jurisdiction, which likewise failed of passage, was the Attorney General's Bill of 1932. See Clark, Diversity of Citizenship Jurisdiction of the Federal Courts (1933) 19 A. B. A. J. 499; Warren, Corporations and Diversity of Citizenship (1933) 19 Va. L. Rev. 691. Since Erie R. R. v. Tompkins, 304 U. S. 64 (1938), the advantages to be sought in the federal courts, so far as substantive law is concerned, have probably been lessened. Nevertheless, inducements such as an appointive judiciary and a different procedure may still make the federal courts more attractive to corporations. See Shulman, The Demise of Swift v. Tyson (1938) 47 Yale L. J. 1336.
the district where the defendant has committed the acts of infringement and has a regular and established course of business. Since such an action arises under a federal law, the Neirbo rule might be applied to lay the venue in a district where the defendant corporation simply has an established course of business and a statutory agent, obviating the necessity that the acts of infringement also occur in that district. But it may be argued that such suits are controlled only by the special patent section. Consequently, although appointment of an agent operates as a waiver of a general objection to venue under Section 51, it does not eliminate those objections based on the specific requirements of the patent section. It may be further argued that the decision relates only to suits subject to the concurrent jurisdiction of the federal and state courts. In the latter event, patent suits, which are subject only to the exclusive jurisdiction of the federal courts, are not affected.

To approve the result in the Neirbo case is not necessarily to approve the argument employed to produce that result. Juristic symmetry is scarcely expected when stare decisis is disturbed, but change should be justified by sound argument. Mr. Justice Frankfurter rather obscures the fact that he is overthrowing what had been considered established doctrine for many years by the majority of courts and textwriters, alike. The reasoning on which he relies to carry the Schollenberger doctrine through the statutory change which eliminated "found" from the venue section involves somewhat strained interpretations both of that holding and of the background of the

38. This argument may be somewhat strengthened by the provision in the patent section that "If such suit is brought in a district in which which the defendant is not an inhabitant, but in which such defendant has a regular and established place of business, service of process . . . may be made by service upon the agent . . . conducting such business in the district in which suit is brought." 36 Stat. 1100 (1911), 28 U. S. C. § 109 (1934). It would seem that this provision has been added on the assumption that the ordinary bases for service on a foreign corporation are not applicable to such suits.
41. "But the crux of the [Schollenberger] decision is its reliance upon two earlier cases, Baltimore & Ohio R. R. v. Harris, 12 Wall. 65 . . . and Lafayette Ins. Co. v. French, 18 How. 404 . . . recognizing that 'consent' may give 'venue.'" 60 Sup. Ct. 153, 156 (U. S. 1939). The essential problem in the Lafayette case was whether a state court, acting under a state statute authorizing service of process on the agent of a foreign corporation doing business within the state, had the power to enter a valid in personam judgment against such a corporation. The Harris case likewise appears to have been concerned primarily with the problem of serving a foreign corporation that was theoretically "non-existent" where it was doing business. Both cases represent an attempt to overcome the logical implications of Taney's doctrine by basing personal jurisdiction upon the fiction of consent. See note 7 supra. But the proper service of process requisite for an in personam judgment is distinct from, and does not dispense with, the requirements for venue; nor does proper venue eliminate the necessity of obtaining personal jurisdiction over the defendant. See Robertson v. Railroad Labor Board, 268 U. S. 619, 622 (1925).
1887 venue statute. Basing waiver of federal venue on an appointment made under a state law whose chief purpose is to provide for service of process lends a further air of unreality to the Court's effort to replace "metaphor with common sense."

The solution dictated by the Court's reasoning does not neatly tie up the loose ends of the venue problem. Inasmuch as 47 states have statutes providing that all foreign corporations, in order to qualify to do business, must appoint some sort of service agent—either an actual agent or a public official, or both—the rule will operate to include most corporate defendants. But if the case is construed strictly, a discriminatory venue privilege may still be reserved to those law-breaking foreign corporations which do business without registering or appointing a statutory agent, and which can scarcely be said to have "consented" to waive venue. The opinion likewise indicates the possibility of appointments of agents for service of process under the express reservation of the corporation's venue privilege. If the state consents to such appointments, the courts will have to determine whether the reservations circumvent the Neirbo rule. If such reservations are refused, then the

42. After discussing the attempt of the House of Representatives to bar from the federal courts diversity suits between foreign corporations and citizens of the states in which they were doing business, the majority opinion states: "It would be strange indeed if the House in § 1 had dealt with the 'venue' of suits against corporate litigants who, like those involved in the Schollenberger case, by § 3 of the same bill were completely barred from the federal courts." 60 Sup. Ct. 153, 157 (U. S. 1939). But § 3 did not bar all suits involving foreign corporations. Suits based on federal questions and diversity suits between a foreign corporation and a non-resident—the very situation in the Neirbo case—could still be brought in the federal courts under that provision. See note 46 infra.

43. See PARKER'S CORPORATION MANUAL (41st ed. 1940) #49, 52. Georgia is the only state that makes no special provision for service on foreign corporations. But it appears that a foreign corporation can be served in the way provided for domestic corporations. City Fire Insurance Co. v. Carrugi, 41 Ga. 660 (1871). For discussion of the various types of statutes, see Culp, Constitutional Problems Arising from Service of Process on Foreign Corporations (1935) 19 MINN. L. REV. 375.

44. In their statutes dealing with foreign corporations, some states use words equivalent to "consent to be sued," whereas others simply provide for "agent for service of process." Since the Neirbo opinion clearly holds that the latter form is sufficient to create a waiver of venue, the former is a fortiori effective. See Oklahoma Fueling Co. v. Oklahoma Gas & Electric Co., 60 Sup. Ct. 215, 219 (U. S. 1939); Neirbo Co. et al. v. Bethlehem Shipbuilding Corp., 103 F. (2d) 765, 769 (C. C. A. 2d, 1939).

45. The anomaly of such unlicensed foreign corporations enjoying an advantage over registered corporations solely by reason of their failure to register has already been illustrated in the judicial treatment of actions arising outside the state of business activity. If the corporation, in accordance with the statute, has appointed a public official to receive process, the courts of the state have jurisdiction over all transactions no matter where arising. Pennsylvania Fire Ins. Co. v. Gold Issue Mining & Milling Co., 243 U. S. 93 (1917); Smolik v. Philadelphia & R. Coal & Iron Co., 222 Fed. 148 (S. D. N. Y. 1915). But if the corporation has not expressly appointed such official, it has not subjected itself to causes of action arising from business not done within the state. Old Wayne Mut. Life Ass'n v. McDonough, 204 U. S. 8 (1907); Simon v. Southern Ry., 236 U. S. 115 (1915).
courts will be asked to decide whether the states are unconstitutionally depriving a corporation of a federal privilege as a condition of doing business.

It is admittedly difficult to conceive of a corporation as being a "resident" anywhere. Since Congress used this term in a venue statute applicable to individuals and corporations alike, however, the courts were forced to augment its literal meaning by the fiction that corporate residence meant state of incorporation. That this fiction, created to cope with the corporate entity in its earlier stages, no longer fits the corporation full-grown was ignored in the Neirbo decision. The Court chose to accept the anachronistic device and to interpolate a further concept: appointment of an agent for service of process according to state law constitutes a waiver of federal venue. There remain, as a result, loopholes through which corporations might escape the Neirbo rule by registering with reservation of venue privileges or by failing to register altogether.

The Supreme Court could have rested its decision on grounds considerably more productive of certainty in the elimination of the discriminations which it sought to erase. The opportunity was at hand peacefully to inter the outworn concept that a corporation is resident only in the state of its incorporation, and to erect in its place the more realistic doctrine that a corporation is resident, for purposes of venue, wherever it does business. Such a doctrine would go no further than the Neirbo rule, but would definitely shut off the possible avenues of escape. Limited to venue, it would not necessarily affect diversity of citizenship jurisdiction or prevent removal to the federal courts by non-residents in diversity cases. But it clearly would put venue requirements upon a sound theoretical basis, consonant with the actual position of the corporation and with principles of fair dealing.

46. Such a doctrine could be reconciled more readily than the Neirbo rule with the House's repeated attempts to keep from the federal courts suits involving foreign corporations and citizens of the state in which they were doing business. Evidently, the theory behind such a provision was that a corporation doing business in a state is, at least for purposes of suit, a citizen or resident of that state. The wording of the Attorney General's Bill, designed to achieve the same end, would seem to confirm this. See S. B. 937, 72d Cong., 1st Sess. (1932). Consequently, although the jurisdictional restrictions applied only to a limited set of cases, their basic theory could be assimilated into the general venue requirements for such "foreign" corporations.

47. The doctrine would of course destroy a long line of cases. See note 13 supra. But the court undertook in the Neirbo case to overthrow a rule established since 1892.

48. It is entirely possible that the same word may be used differently in two different statutes. In Lamar v. United States, 240 U. S. 60, 65 (1916), Mr. Justice Holmes said: "The question is in what sense the word 'officer' is used in the Criminal Code . . . The same words may have different meanings in different parts of the same act . . ." See also American Surety & Trust Co. v. District of Columbia, 224 U. S. 491, 494 (1912).
RESERVATION OF MOTION FOR DIRECTED VERDICT
IN FEDERAL CRIMINAL TRIALS*

In 1938 the Supreme Court in *Erie Railroad v. Tompkins* \(^4\) destroyed the concept of a federal, or general, common law as it was applied to certain civil cases. \(^2\) But the concept still exists in the field of federal criminal procedure. \(^3\) Neither the Rules of Decision Act, \(^4\) requiring federal courts to follow state law wherever applicable, nor the Conformity Act, \(^5\) adopting state procedure for federal courts, has been applied to criminal cases. \(^6\) Inasmuch as Congress has seldom legislated on criminal procedure, \(^7\) federal courts have been forced to erect a federal common law to cover many procedural problems arising in criminal prosecutions. \(^8\) That the judicial process of molding a federal common law in criminal procedure is not without its regrettable results in some instances is shown by a recent mandamus proceeding in the Seventh Circuit. \(^9\)

The proceeding arose out of the trial judge's action in the recent criminal anti-trust prosecution against the major mid-western oil companies at Madison, Wisconsin. \(^10\) Following submission of the case to the jury and the return of verdicts of guilty against forty-six defendants, the trial judge


1. 304 U. S. 64 (1938).

2. The Federal Rules of Civil Procedure, of course, are not included within the limitation of the *Tompkins* case except in so far as the rules may include substantive law. Cf. Cities Service Oil Co. v. Dunlap, 60 Sup. Ct. 201 (U. S. 1939).

3. Federal common law may exist in other fields such as bankruptcy, patents and the like where federal courts in enforcing a purely federal right have to go beyond statutory law. See Shulman, *The Demise of Swift v. Tyson* (1938) 47 YALF L. J. 1336, 1350. On the other hand, there are no federal common law crimes. United States v. Hudson, 7 Cranch. 32 (U. S. 1812).


6. United States v. Reid, 12 How. 361 (U. S. 1851) (Rules of Decision Act inapplicable). The Conformity Act is worded to apply only to civil actions.

7. A notable exception is the Act of February 24, 1933, as amended, 47 STAT. 904 (1933), 48 STAT. 399, 28 U. S. C. § 723a (1934), authorizing the Supreme Court to promulgate uniform rules for appeals in criminal cases.

8. For a general discussion of these problems with reference to rules of evidence, see Leach, *State Law of Evidence in the Federal Courts* (1930) 43 HARV. L. REV. 554; Comment (1934) 47 HARV. L. REV. 853.


entertained and, several months later, granted motions to set aside the verdict and dismiss the charge as to eleven defendants. After protests by Government counsel had been entered, the judge issued two nunc pro tunc orders to show that he had previously reserved decision on motions for directed verdicts and that his dismissal of eleven defendants was in accordance with the reservation on these motions and not pursuant to the motions to set aside the verdict. The Government then sought a withdrawal of the judge’s orders and a reinstatement of the jury’s verdict. Upon refusal of the trial judge to retract his rulings, the Government, having no right of appeal, took the only available course. It sought a writ of mandamus from the circuit court of appeals on the grounds that no reservation was in fact made and that, with or without reservation, the trial judge had no power to enter a verdict of acquittal. The circuit court of appeals set aside the first contention of the Government by declaring that the trial judge’s answer to the show cause order, in which he stated that he did reserve decision, was conclusive. The appellate tribunal then answered the Government’s second contention by holding that a trial judge has power to acquit a defendant on a reserved motion for directed verdict in a criminal trial.

Since the power to enter a verdict of acquittal on a reserved motion is not derived from any federal legislation, the court had to ascertain the common law on the subject. The source of federal criminal procedure, the court decided, was the common law of the state in which the trial took place as of the date of admission to the union. A dictum in a case in Wisconsin, the state of the trial, was then cited as authorizing a trial judge to dismiss a defendant notwithstanding the verdict. This approach is erroneous, however, because in 1934 the Supreme Court in *Funk v. United States* repudiated the doctrine that the common law of the state as of the date of admission should be followed and substituted a doctrine of a general common law by which the federal courts may modernize criminal procedure “in the light of general authority and sound reason.” The purpose of the *Funk* case was,

12. Transcript of Record 155, 156, United States v. Stone, 60 Sup. Ct. 177 (U. S. 1939).
13. The United States may appeal in a criminal case only from an order quashing, setting aside, or sustaining a demurrer to an indictment; an order granting a motion in arrest of judgment; or an order sustaining a special plea in bar, provided always that the order is based upon the validity or construction of the statute upon which the indictment is founded. 34 STAT. 1246 (1907), 18 U. S. C. §682 (1934). Certiorari may, of course, be applied for where an appellate court reverses a conviction.
14. In answer to the order to show cause why he should not be ordered to reinstate the jury verdict, the trial judge set forth excerpts from the trial record which, the trial judge maintained, showed that he had reserved decision on the motion. The circuit court of appeals independently considered the facts and came to a similar conclusion.
16. Logan v. United States, 144 U. S. 263 (1892) was cited for this proposition.
17. State v. Meen, 171 Wis. 36, 39, 176 N. W. 70, 72 (1920).
obviously, to circumvent a static procedure unchanged from early common law. Although it may be argued that this very purpose was served by the circuit court's of appeals use of the Wisconsin dictum, such justification ignores the basic premise of the Funk case—that the federal court make an independent judgment in determining the applicable procedure. To follow a Wisconsin court strictly as authority is to accept blindly that court's determination as to the acceptable modern procedure and to deny the independence of federal procedure from state practice.

The circuit court of appeals did not, however, content itself with accepting the Wisconsin rule. An independent consideration of the common law was also undertaken to justify the trial judge's reservation. Here the court was faced with the fact that a motion for directed verdict had apparently never been reserved in criminal cases either in England at common law or in this country outside of Wisconsin. Not until 1848, when Parliament created the Court of Crown Cases Reserved, could an English court correct an error once the jury had returned a verdict. Previously, periodic informal meetings of all the trial judges were held at which were considered errors committed at trial by any one of them. If the judges decided that a conviction was in fact an erroneous one, a pardon was recommended to the king. This peculiar practice, the circuit court of appeals explained, was enforced by the judges out of fear of offending the crown, a condition which did not exist in this country; consequently, there was no reason for American courts to distinguish between early English criminal procedure, where the judge could not dismiss the defendant, and early English civil procedure where the judge could reserve a motion for directed verdict. In the absence in this country of a struggle between king and judiciary, therefore, criminal procedure should be the same as civil procedure.

There are, however, two difficulties with this facile solution of the problem. In the first place, the principal value of a reserved motion in a civil action is that it permits the appellate court to dispose of the case without ordering a new trial. Its use, so far as federal courts are concerned, is to circumvent the objection that disposition of the case on appeal is contrary to the provision for trial by jury in civil cases. Yet in criminal cases the reservation does not appear to be necessary. Appellate courts have often discharged defendants because of erroneous denial of a directed verdict. Consequently, adoption of the civil procedure by analogy seems unconvincing when the reason for

20. 11 & 12 Vict. c. 78 (1848).
22. Ibid.
25. Slocum v. New York Life Ins. Co., 228 U. S. 364 (1913), held that where a motion for directed verdict was erroneously denied, the appellate court could only reverse and remand for a new trial. Otherwise, the right to trial by jury would be denied.
using the procedure is not present. In the second place, outside of Wisconsin, it does not appear that state judges follow a practice of reserving motions on directed verdicts in criminal cases.\textsuperscript{27} If the doctrine in the \textit{Funk} case is limited to the proposition that federal courts “look to the spirit of modern legislation, and to the trend of decisions both federal and state to determine what is the true and enlightened rule,”\textsuperscript{28} there is considerable question whether the trial judge’s action in the principal case is in accord with the “true and enlightened” rule. A strongly reasoned justification should be required to introduce a novel procedure deemed unnecessary in almost all states.

If, however, the \textit{Funk} rule is broadened to include the doctrine that federal courts are completely free to adopt any procedure commensurate with the spirit of the common law, then it is necessary to examine more closely the trial judge’s action to see whether it is acceptable as an innovation in federal criminal trials. The first question to be answered is whether the \textit{Funk} rule should be extended beyond its original purpose, the liberalization of the rules of evidence, and used to permit a procedural reform vitally affecting the Government’s rights in a criminal case. The \textit{Funk} case was an example of judicial legislation in a situation where Congress had been grossly negligent in failing to abolish antiquated rules of evidence.\textsuperscript{29} With state criminal procedure long since moved far beyond federal practice, it would be too much to expect federal judges to ignore modern trends when an opportunity for reform arose. The problem of the reserved motion for directed verdict is a different matter. Here judicial legislation is further increasing the powers of a trial judge in a class of cases in which the prosecution has few rights. The absence of right to appeal places the Government at the mercy of the trial judge.\textsuperscript{30} To permit a judge to dismiss defendants five months after trial, as in the principal case, is to increase further the Government’s subjugation to the irremediable caprice of a trial judge.

It may be argued, of course, that the power to reserve a motion for directed verdict is only a matter of form because the legal basis for directing a verdict does not change with the passage of time. What is sufficient to set aside a verdict after trial is sufficient to direct a verdict before the jury retires. Although true in the abstract, this argument overlooks factors which make it possible that a trial judge might direct a verdict on a reserved motion where he would not have during trial. If he is at all in doubt at the conclusion of the trial, he may decide not to direct a verdict, but to send the case to the jury, because in the event the jury fails to acquit, he still has an opportunity

\textsuperscript{27} This cannot be proved, of course. There is a negative inference to be drawn from the fact that treatises on criminal procedure and criminal law do not mention it, and that neither the district judge nor the circuit court of appeals cites either case or statute authorizing it. In State v. Bossio, 136 Wash. 232, 234, 239 Pac. 553, 554 (1925), the court mentions that by agreement of counsel and judge argument on a motion for directed verdict was postponed until after verdict. The question was not in issue, however, and the court does not even by dictum approve the procedure.

\textsuperscript{28} \textit{Ex parte} United States, 101 F. (2d) 870, 877 (C. C. A. 7th, 1939).

\textsuperscript{29} See Comment (1934) 47 HARV. L. REV. 853.

\textsuperscript{30} See note 13 supra.
to grant a new trial should he believe the verdict erroneous. If he waives, however, the doubts may be removed because the impression of witnesses' credibility will be lost in a "cold" record, or because careful study of the record may lead to conclusions different from those reached as the case unfolds at trial. On the other hand, this danger in reviewing a "cold" record is avoided on appeal by a natural advantage to the party who won in the court below. It is quite likely, therefore, that many times during trial the judge would deny a motion to direct a verdict where he might alter his opinion if he had more time to study the record. In such a case the defendant is protected by his privilege to move for a new trial or to appeal. The Government, on the other hand, is protected from an erroneous dismissal which the judge might order after verdict.

Apart from the importance of protection to the Government, other considerations make the action of the trial judge in the principal case of doubtful value. In the first place, his subsequent review of the case upsets the allocation of power between trial court and appellate court. With sufficient provision for appellate review, there seems no reason to require a trial judge to neglect his trial work in order to review his own case. In the second place, a trial judge, secure in the knowledge that he can review the case for error, may tend to be less attentive in the conduct of the trial. The necessity for ruling at the conclusion of the presentation of evidence on a motion for directed verdict will require close attention to all aspects of the trial; if the ruling is to be based on the transcript of the trial, the judge may be careless about excluding evidence because he knows that upon reviewing the transcript he can discount any erroneous admission.

There appears to be only one strong argument offered in favor of granting a judge power to defer his ruling on a motion for a directed verdict. It is supposed to give him time in a difficult case to study the record more thoroughly without having to keep the jury sequestered. It is true, of course, that there were forty-six defendants in this anti-trust suit, that the evidence was extremely complex and that a hasty ruling might be erroneous. Yet an anti-trust suit is just the type of action which ought not to be subjected to the ruling of a trial judge where no appeal can be taken. Anti-trust prosecution involves an important public policy which should be unified and coordinated by similar judicial enforcement across the country. As an aid to obtaining unified enforcement, the Government needs an extensive privilege

31. The advantage to the appellee is a practical, not a legal, one. Such factors as the fact that one trial has already been held, that litigation should be brought to an end, that the appellate court cannot consider all possible errors, and that the trial judge must be given some discretion affect the disposition of a case on appeal.

32. See United States v. Lowenstein, 126 Fed. 884 (E. D. Pa. 1904), where the trial judge granted a new trial and told the Government not to bother with another prosecution unless more evidence could be produced.


34. The trial lasted for over three months and the transcript of the trial contained "some twelve thousand pages of evidence and over one thousand exhibits." Transcript of Record 165, United States v. Stone, 60 Sup. Ct. 177 (U. S. 1939).

35. Cf. Fairman, Mr. Justice Miller and the Supreme Court (1939) 90, n. 42.
of review by appellate courts. The trial judge’s ruling in the principal case, however, is one more step in the process of destroying what limited opportunity the prosecution has to coordinate its policy.36

In view of the conceded complexity of anti-trust suits, and perhaps of other criminal suits as well, there may be considerable justification for the grant of power to a trial judge to defer his ruling. Such a grant should, however, be accompanied by protection to the Government by way of a right to appeal.37 Otherwise, as in the principal case, the result is to increase a trial judge’s power without a corresponding appellate review which the Government can invoke. Judicial legislation, though an accepted mode of molding law, seems singularly inappropriate when it results in an increase of power in lower federal courts at the expense of efficient prosecution.38

DISPARITIES IN TIME LIMITATIONS ON FEDERAL CAUSES OF ACTION*

Federal statutes conferring private rights typically fail to provide periods of time limitation during which such rights must be asserted. To resolve the dilemma created by Congressional inaction, the Supreme Court has declared that in the absence of an applicable federal statute of limitations, that of the state in which the district court is situated must be applied, though the cause of action arise solely under federal law. In attempting to rectify legislative inertia, the Court has supplied at least a workable and definite solution to the problem raised thereby. Yet the result is not a completely satisfactory one. Quite apart from mere difficulties of application in particular instances, more fundamental inconsistencies, both in legal theory and practical effect, lurk in the doctrine. An attempt to use the Federal Rules of Civil Procedure to escape the incidence of the rule in a recent case

36. Contrast the attitude of Judge Lindley, in denying a motion for directed verdict in the criminal prosecution of the General Motors Corporation, where he said he would permit the case to go to the jury without deciding whether the facts were sufficient in law, because he did not feel he should destroy the Government’s chances of having the question passed on by the Supreme Court. N. Y. Times, Oct. 26, 1939, p. 16, col. 4.

37. An appeal from a verdict of acquittal on a reserved motion would probably not involve double jeopardy because the appellate court would not need to order a new trial but could reinstate the jury’s verdict of guilty. In fact, even allowing a new trial after appeal by the government on a verdict of not guilty may be found not to contravene the constitutional prohibition against double jeopardy. See the comments of Mr. Justice Cardozo in Palko v. Connecticut, 302 U. S. 319, 323 (1937).

38. This objection applies even more strongly to the argument, used by the circuit court of appeals in the principal case, that the trial judge possesses “inherent power” to reserve a motion for a directed verdict.

1. 1 Moore, Federal Practice (1938) 240.
invites an examination of the possible utility of this and other devices to evade or correct its imperfections.

On the ground of the statute of limitations, defendant moved to dismiss an action for triple damages brought under the Clayton Act in the federal district court of Delaware. No federal statute of limitations was applicable; Delaware provides a three-year limitation for actions on the case. It was stipulated that the right of action had accrued more than three years previous to the commencement of suit. Plaintiff argued that since the Federal Rules of Civil Procedure abolish common law forms and provide for but one form of action to be known as a civil action, a statute limiting actions “upon the case” is inapplicable. The court rejected this argument and granted defendant’s motion to dismiss, reasoning that the substance and not the form of action is decisive. Had the framers of the rules intended the extreme result propounded by plaintiff, they would, thought the court, have explicitly so stated.

In rejecting as specious the theory advanced to defeat defendant’s motion to dismiss, the court was on solid doctrinal ground. When states have substituted code pleading for common law forms of action, existing statutes of limitations have continued to prevail, affecting not the form but the substance of the cause of action stated. Any other result would be at variance with the theory and practice of code pleading orthodoxy. Moreover, it is well settled that an action for triple damages under the Clayton Act is substantially one of case. Yet despite the invalidity of the plaintiff’s argument in the instant case, the unsatisfactory nature of the doctrine requiring application of state limitation statutes to actions brought under federal law becomes accentuated in the light of the Federal Rules of Civil Procedure. Uniformity and simplicity are their twin objectives. One area in which uniformity would seem most essential is in the operation of federal statutes giving substantive rights to private parties. Instead, there are as many different time limits upon such causes of action as there are distinct state statutes of limitations. The practical result is obvious: one who has delayed in asserting a federal right

7. Hermes v. Westchester Racing Ass’n, 213 App. Div. 147, 210 N. Y. Supp. 114 (1st Dep’t 1925); Note (1926) 35 Yale L. J. 508. Nor should the relief sought by plaintiff complicate the applicability of the substantially appropriate statute of limitations. Model Building & Loan Ass’n of Mott Haven v. Reeves, 236 N. Y. 331, 140 N. E. 715 (1923).
9. H. J. Jaeger Research Laboratories v. Radio Corp. of America, 90 F. (2d) 826 (C. C. A. 3d, 1937). Plaintiff’s argument in the instant case that his action was one of debt on a specialty was given extensive consideration by the court.
10. See 1 Moore, Federal Procedure § 0.01 and passim.
may still prevail if his adversary is subject to suit in a district where the
state provides a sufficiently generous time limit.\footnote{11} Otherwise his action is
barred. Such disparity in its operation could hardly have been intended
by the framers of a supposedly uniform federal statute.

If the rule itself defeats the ideal of uniformity, practical difficulties in
its application destroy that of simplicity. The question must invariably arise
as to which of the many limitation periods provided by the state is applicable.
To this end federal courts have been called upon to consider, \textit{inter alia},
whether stockholders' liability under the National Banking Act was statutory
or contractual,\footnote{12} whether infliction of injury caused by violation of the
Safety Appliance Act raised a liability "for personal injury" or one "created
by statute,"\footnote{13} whether an action for triple damages under the anti-trust laws
was for a statutory penalty or the infliction of injury,\footnote{14} and whether suit
for injuries resulting from violation of the national election laws was for
damages or for a penalty.\footnote{15} Upon such exiguous and seemingly academic
distinctions has often depended the disposition of federal causes of action.
Another difficulty which has been raised is the effect to be given in the
federal courts to the "borrowing" statute of limitations of a state.\footnote{16} Since
the advent of the Federal Rules of Civil Procedure, a third question which
has threatened trouble and excited comment is that of when an action is
"commenced" in the federal courts for the purpose of tolling the appropriate
limitation statute.\footnote{17}

\footnote{11} On occasion the courts have frankly recognized that plaintiff brought his federal
action in a given jurisdiction for the very purpose of taking advantage of an indulgent
state limitation. See Bluefields S. S. Co. v. United Fruit Co., 243 Fed. 1, 20 (C. C. A.
3d, 1917) (action for triple damages under Sherman Act brought in Pennsylvania for
this purpose. A wider choice of forums seems now available for actions under some
federal statutes (\textit{e.g.}, patent infringement suits). See Neirbo v. Bethlehem Shipbuilding

\footnote{12} McClaine v. Rankin, 197 U. S. 154 (1905) (statutory).

\footnote{13} Nichols v. Chesapeake & O. Ry., 195 Fed. 913 (C. C. A. 6th, 1912) ("created
by statute").

1922) (injury inflicted).

\footnote{15} O'Sullivan v. Felix, 233 U. S. 319 (1914) (question whether federal limitations
statute or that of Louisiana was applicable). For an analogous problem, see Glenn Coal

\footnote{16} That is, a state statute which provides that no action may be entertained in its
courts if it is barred by a statute of limitations of the state where the cause of action
arose. See Bluefields S. S. Co. v. United Fruit Co., 243 Fed. 1, 20 (C. C. A. 3d, 1917);
Gallagher v. Carroll, 27 F. Supp. 568 (E. D. N. Y. 1939) (jurisdiction founded on diver-
sity). In both these cases such statutes were involved, but in each the court was able
to sidestep a decision of their effect. For decision of an analogous question, see Metcalf"

Proc.} 3 provides "a civil action is commenced by filing a complaint with the court." Some
states provide that action is commenced by service of summons (\textit{e.g.}, \textit{N. Y. Civ.
Prac. Act} § 218). The instant case temporarily allays fears that federal courts would
bow to state practice in this matter. See 1 \textit{Moore, Federal Practice} § 3.06; \textit{Comment}
These inherent inconsistencies and sources of pragmatic difficulty the courts have complicated even further. Though under Supreme Court mandate not to interfere with a state statute of limitations unless the time allowed is so short as to deprive the parties of a reasonable opportunity to protect their rights, federal courts have sought escape from the rigidity of limitations statutes in various ways. With numerous state limitation periods from which to choose, courts have been able to exercise in legal actions a substantial degree of discretion in deciding whether or not the federal right is barred. This exercise of discretionary selection, though motivated by an understandable desire not to withhold relief in appropriate instances, has detracted even further from the semblance of consistency. Another highly important escape device open to the courts is provided by the theory that in equity the otherwise appropriate limitations statute is applicable only by analogy; the court is free to disregard it in any instance where the plaintiff appears not in fact guilty of laches. The doctrine has been called insignificant, but an examination of recent decisions would seem to indicate that such is not the case. Though justifiable to promote fairness in individual cases, the concept appears to create a situation quite contrary to the purposes of the Federal Rules of Civil Procedure. It tends substantially to frustrate the desired union of law and equity; indeed it has created a source of pressure upon the courts to classify causes as equitable which upon traditional criteria could hardly be so categorized.

Defects so substantial in the rule applying state limitation statutes to causes of action arising under federal law justify a critical examination of the origin and rationale of the rule. It is suggested that such an examination will provide an argumentative basis for reaching the result contended for by the plaintiff in the principal case, upon grounds quite distinct from those he asserted.

18. Wheeler v. Jackson, 137 U. S. 245 (1890). This would normally be the situation only in the case where a new, shorter limitation has been imposed on an already existing cause of action.


Though it was early decided that federal courts must apply state limitation statutes in cases where their jurisdiction is concurrent with state courts,\textsuperscript{25} the Supreme Court was long silent upon the question of whether the same rule should apply when jurisdiction is exclusively federal. The weight of authority in the circuit courts supported the position that a federal cause of action could not be limited by a state statute of limitations.\textsuperscript{26} This position was repudiated and the present rule expounded when in \textit{Campbell v. Haverhill}\textsuperscript{27} the Supreme Court decided that the Massachusetts limitation for torts barred an action in a federal court for patent infringement, in the absence of an applicable federal limitations statute.\textsuperscript{28} The basis of the doctrine is the Rules of Decision Act.\textsuperscript{29} The Court was unmoved by the argument that that Act is inappropriate since it requires United States courts to regard state laws as rules of decision only "in cases where they apply."\textsuperscript{30} It was argued that the states were powerless to limit rights of action which they had not created and over which they had no jurisdiction, and that therefore their limitation statutes did not "apply" to federal substantive rights. Troubled by the prospect of actions without time limit, the Court ruled that the 'distinction' drawn by plaintiff was not of sufficient magnitude to outweigh the beneficent purposes of limitations statutes.\textsuperscript{31} Thereafter the rule itself seems never to have been seriously questioned.\textsuperscript{32}

The argument advanced against the rule at its inception might well have prevailed.\textsuperscript{33} Another, attractive at least as a syllogization, becomes available.

\begin{thebibliography}{9}
\bibitem{27} 155 U. S. 610 (1895).
\bibitem{28} The general Patent Act of 1870 had provided a time limitation for infringement suits, 16 Stat. 206, § 55 (1870). The clause was omitted, however, in the compilation of the Revised Statutes (1875).
\bibitem{30} "The laws of the several states, except where the Constitution, treaties, or statutes of the United States otherwise require or provide, shall be regarded as rules of decision in trials at common law, in the courts of the United States, in cases where they apply." Rev. Stat. § 721 (1875), 28 U. S. C. § 725 (1934).
\bibitem{31} The court quoted the eulogistic characterization of time limitations from Mr. Justice Story's opinion in \textit{Bell v. Morrison}, 1 Pet. 351, 360 (U. S. 1828). But even if one agree that a statute of limitations is "a wise and beneficial law," it does not follow that that of the state should control federal causes of action.
\bibitem{32} Though litigation has flourished as to its applicability in particular instances. O'Sullivan v. Felix, 233 U. S. 319 (1914); Chattanooga Foundry & Pipe Works v. Atlanta, 203 U. S. 390 (1906); Todd v. Russell, 104 F. (2d) 169 (C. C. A. 2d, 1939).
\bibitem{33} The court in \textit{Campbell v. Haverhill} nowhere satisfactorily answered plaintiff's argument. See note 31 \textit{supra}. His reasoning had previously been accepted by a majority of the circuit courts. See note 26 \textit{supra}. Moreover it appears to have been previously settled that the Rules of Decision Act did not operate to make state survival statutes apply to causes of action arising solely under federal law, a highly analogous situation. "[The Rules of Decisions Act] . . . refers to cases where the federal courts obtain jurisdiction by reason of the citizenship of parties, and has no application to those cases in
since passage of the Federal Rules of Civil Procedure. The decision in *Campbell v. Haverhill* was based upon the Rules of Decision Act, a statute which is said to apply not to matters of procedure, but only to those of substance. Yet in branches of the law where it has been necessary to make a formal classification, statutes of limitations have been called procedural. It would follow, even assuming the desirability of the doctrine under discussion, that in the interests of consistency its basis should be not the Rules of Decision Act, but the Conformity Act, which requires federal courts to follow the states in matters of procedure. If it be conceded that this Act is the proper basis for the rule, it then could be argued that the rule is no longer in effect, in view of the frequently made statement that the Conformity Act has been repealed by the Federal Rules of Civil Procedure.

Had the plaintiff in the principal case advanced the argument herein suggested, he would have been on verbally defensible ground, yet to presume which the jurisdiction of the court arises out of the cause of action, and consequently involves rights over which the State legislature can exercise no authority . . . [Otherwise] . . . there would be one rule of action in this respect governing copyright suits in one state, and another in other states, dependent upon local legislation respecting the survival of action." *Schreiber v. Sharpless*, 17 Fed. 589 (E. D. Pa. 1883).


A statute of limitations becomes substantive when it is so identified with a right of action as to be inseparable therefrom. *Davis v. Mills*, 194 U. S. 451 (1904); *Gregory v. Southern Pacific Co.*, 157 Fed. 113 (C. C. Ore. 1907). Restatement, Conflict of Laws (1934) §605. This exception to the general rule that limitation statutes are procedural is highly important in the conflict of laws and in some other connections. See Clark, Code Pleading (1928) §95; Atkinson, *Pleading the Statute of Limitations* (1927) 36 Yale L. J. 914. It is when statutes which create the right place a time limit upon the remedy that the limitation is said to be substantive. Obviously the exception is of no importance to the problem under discussion, since states cannot create federal rights. The statutes of limitations of the states which the federal courts have applied to federal causes of action are therefore invariably general ones, and invariably "procedural."

36. "The practice, pleadings, and forms and modes of proceeding in civil causes, other than equity and admiralty causes, in the district courts, shall conform, as near as may be, to the practice, pleadings, and forms and modes of proceeding existing at the time in like causes in the courts of record of the State within which such district courts are held, any rule of court to the contrary notwithstanding." Rev. Stat. §914 (1875), 28 U. S. C. 724 (1934). For a critical discussion of the operation of the Conformity Act, see Comment (1927) 36 Yale L. J. 853.

that such an argument would have prevailed is little short of fantastic. For
too long the courts have paid lip service to the proposition that it is the
Rules of Decision Act which supports the doctrine, with but one isolated
case indicating a possible recent deviation from that rationale.\(^8\) Moreover,
rectification of the apparent inconsistency at this late date would result in
confusion. In the first place there can be no doubt that in instances where
jurisdiction of the federal courts is concurrent with that of the states, as in
diversity of citizenship cases, the state statute of limitations should prevail.
For here not uniformity but conformity is the ideal. Yet, if the argument
be accepted, the applicability of state limitations would be completely subject
to judicial discretion in such cases.\(^9\)

Secondly, it is difficult to see how the desideratum of uniformity could be
achieved in federal causes of action by mere judicial repudiation of the
Campbell v. Haverhill rule. If the doctrine were rejected, on the grounds
suggested or on any other grounds, federal rights would be left with no
apparent time limitation upon them,—the in terrorem exigency which was
the rule’s genesis.\(^10\) Actually in such a situation, at least two devices would
be available by which the courts could set up a temporal bar,—neither com-
pletely satisfactory. The twenty-year common law presumption would make
for uniformity but would provide a longer period than is generally considered
advisable.\(^11\) The flexible doctrine of laches would be available, as now, in
cases historically equitable, and, since the consummated union of law
and equity, conceivably in every “civil action;”\(^12\) but this practice would
hardly promote uniformity. A third possibility would be discretionary incor-
poration of state limitations,\(^13\) precisely the unsatisfactory situation which
is now mandatory.

\(^{38}\) Guaranty Trust Co. v. United States, 304 U. S. 126, 131 (1938). In deciding that
the New York limitation runs against the United States suing in a federal court as
assignee of a foreign government, the Court nowhere mentions the Rules of Decision Act.
The Conformity Act is mentioned twice. The first reference may deal with the manner
of pleading the statute of limitations, but it is difficult to explain the second reference on
those grounds: “Respondent argues [that it is] . . . not subject to statutes of limita-
tions, and its immunity as in the case of a domestic sovereign constitutes an implied ex-
ception to that statute and to the Conformity Act.” (Italics supplied).

\(^{39}\) Under Fed. Rules Civ. Proc. 83, district courts are given discretion to regulate
their practice in all cases not provided for by rule, in any manner not inconsistent with
the Federal Rules.

\(^{40}\) What expressly motivated the decision in Campbell v. Haverhill was the prospect
of federal rights of action extending indefinitely.

\(^{41}\) The presumption is apparently rebuttable. See Dowthwaite v. Tibbut, 5 M. & S. 75
(K. B. 1816). The British statute of James I limited actions of case to six years. Amer-
ican statutes are roughly comparable but tend to be shorter for most civil actions. It
could be argued that the English statutes passed before 1776 might be available as part
of the inherited common law.

\(^{42}\) It has been suggested that the doctrine of laches should be available in no “civil
actions,” even those historically equitable. See Partridge v. Ainey, 28 F. Supp. 472 (S.
D. N. Y. 1939). It could be argued as defensibly that the doctrine should be available in
all “civil actions,” even those historically legal. See Holsz v. Stephen, 362 Ill. 527, 200
N. E. 601 (1936); Noel v. Tetteau, 116 N. J. Eq. 446, 174 Atl. 145 (Ch. 1934); Notes
Rev. 93.

\(^{43}\) See note 39 supra.
Elsewhere, it would appear, must be sought the possibility of correcting the present doctrine's defective operation. Two agencies suggest themselves. If time limitations are procedural, theoretically the Supreme Court could provide them under the authority by which the Federal Rules of Civil Procedure were promulgated. Yet without an express reversal of the Rules of Decision Act rationale, recent analogous decisions make it improbable that such rules of limitation would be followed by the district courts, since they might still be considered "substantive." Further, the Court might be extremely reluctant to set up time limitations, even assuming its desire to do so, since this function, except in equity causes, has traditionally been legislative. Nor have the federal courts manifested particular displeasure with the prevailing doctrine. One quite simple remedial device, application of an already existing federal statute of limitations, the Supreme Court has long since rejected.

In Congressional action lies, apparently, the only possibility of a completely satisfactory solution. Were the Supreme Court to disclaim the Rules of Decision Act rationale as a basis for the current doctrine, the pressure upon Congress to pass a general statute of limitations would be great. But even if such improbable judicial action does not materialize, it is not entirely utopian to anticipate legislative rescue. Already there are several specific federal statutes of limitations, and one of seeming generality. The impact of the Federal Rules of Civil Procedure will increasingly aggravate the inconsistencies of the present situation, in cases where existing limitations are not applicable. To pass an all-embracing federal statute of limitations would be a simple legislative procedure, uncomplicated by political implications. Such legislation would render substantial service to the even-handed operation of federal law.

44. 48 Stat. 1064, 28 U. S. C. §§ 723b, 723c (1934).
45. The argument would be that the Rule of Decision Act basis of Campbell v. Haverhill indicates that statutes of limitation are substantive, at least for this purpose. Therefore conformity to state limitations would be required, despite the Federal Rules. Since Erie R. R. v. Tompkins, 304 U. S. 64 (1938), the federal rule as to pleading contributory negligence has met such a fate. Francis v. Humphrey, 25 F. Supp. 1 (E. D. Ill. 1938); cf. Cities Service Oil Co. v. Dunlap, 60 Sup. Ct. 201 (U. S. 1939). Yet dictum in the principal case indicates the court would follow limitations covered by the federal rules if any were provided. For criticism of a rigid categorization of substance and procedure, see Cook, "Substance" and "Procedure" in the Conflict of Laws (1932) 42 Yale L. J. 333.
46. Rev. Stat. § 1047 (1875). 28 U. S. C. § 791 (1934) provides a five year limitation on any suit for a penalty or forfeiture under federal law. A liberal construction could have made this a general limitation for all federal actions not specifically otherwise limited. The Court, however, has construed the act narrowly. Meeker & Co. v. Lehigh V. R. R., 236 U. S. 412 (1915); O'Sullivan v. Felix, 233 U. S. 319 (1914); Chattanooga Foundry & Pipe Works v. Atlanta, 203 U. S. 390 (1906).
47. See note 46 supra.
48. By the same token, unfortunately, "... procedure seldom makes a capital political issue, so real progress comes slowly and rarely." 1 Moore, Federal Practice (1938) 2.
APPLICATION OF SECTION 7(d) OF THE PUBLIC UTILITY HOLDING COMPANY ACT TO "NEW MONEY" SECURITY ISSUES*

Federal attempts at investor protection through control over corporate issues of securities have, for the most part, been confined to the disclosure provisions¹ of the Securities Act of 1933.² But this program offers limited protection to the small investor, who, no matter how well informed, lacks the training and judgment to make an intelligent decision on the investment merits of securities.³ Attempts at more extensive safeguards have been made in the limited field embraced by the Public Utility Holding Company Act of 1935,⁴ which seeks, inter alia, to prevent the creation or extension of unbalanced financial structures which might lead to reorganization and resultant investor loss.⁵

Most important of the statutory standards of the Holding Company Act⁶ under which the Securities and Exchange Commission⁷ may regulate financial

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⁵ The Trust Indenture Act of 1939, 53 Stat. 1149 (1939), 15 U.S.C.A. § 77aaa (Supp, 1939), must also be considered as an extension of investor protection beyond the limits of the Securities Act of 1933. The provisions of that Act are designed to safeguard bondholders by requiring minimum protective measures in indentures and assuring responsible trustees urged to vigilant enforcement by omnipresent liability. See generally Banks, Indenture Securities and the Barkley Bill (1939) 48 Yale L. J. 533.
⁶ A good discussion of the security issue standards of the Act is contained in Meck and Cary, Regulation of Corporate Finance and Management Under the Public Utility Holding Company Act of 1935 (1938) 52 Harv. L. Rev. 216, 217–221. A security issuer, unless exempt under the terms of § 6(b), must secure a "license" to issue from the Commission. To secure such license a prospective issuer must meet three sets of requirements. First, his issue must pass muster before applicable state laws. (§ 7(g)). Second, under § 7(c)(1) his security must be either a first lien bond or a par value voting common stock, (or a guaranty of another company's security or a receiver's certificate). The purpose of this requirement is primarily to eliminate from financial structures the ill-treated preferred stockholder and other hybrids whose risk is unreasonable. The immediate effect of this bond-common stock dichotomy is largely dissipated, however, by the exemption (§ 7(c)(2)] from its scope of issues for purposes of refunding or exchange, or issues required for urgent corporate purposes. Operating companies gain still a further exemption from the first lien bond-common stock requirement when the purpose of the issue is to finance company business. As to operating companies, then, the force of § 7(c) probably is nugatory; holding companies, however, will tend gradually toward the ideal structure.

All of these standards, however, are conditions precedent to § 7(d). Even if a security complies with both state laws and § 7(c) it will fail to secure the acquiescence of the Securities and Exchange Commission if that body finds adversely under § 7(d).
⁷ Hereinafter referred to as "Commission."
structures are the provisions of Section 7(d). Under that section the Commission is required to refuse approval to an issue when it finds that:

"(1) the security is not reasonably adapted to the security structure of the declarant and other companies in the same holding-company system; or

“(2) the security is not reasonably adapted to the earning power of the declarant; or

“(3) financing by the issue and sale of the particular security is not necessary or appropriate to the economical and efficient operation of a business in which the applicant lawfully is engaged or has an interest; . . .”

The words of subsections (1) and (2) appear clearly to provide the basis for effective protection of investors by restrictions upon the evils of unbalanced financial structures. The provisions are designed, apparently, to enable the Commission to refuse an applicant permission to issue fixed obligations when the proportion of fixed obligations outstanding to total capitalization is high or when the company's earnings record is unstable. In the refunding cases which have been the practically exclusive business thus far presented under Section 7(d),9 the Commission seems to have so interpreted subsections (1) and (2). While the Commission has not refused an applicant permission to issue, in any reported refunding case, because of failure to conform to these subsections, it has carefully analyzed the financial structure and earnings record of the applicant to determine whether the proportion of debt to equity investment has been high or whether the earnings did not amply cover the fixed charges.10 Where not entirely satisfied with the results of its analysis, rather than denying the right to issue, the Commission has imposed conditions thereon, such as restrictions upon future dividend payments,11 as terms of its approval.12

The Commission's reluctance to bar the right to issue seems to be the result of its view of the special problem presented in refunding cases.13 Since

9. Of the sparse "new" money financing some has been exempted under § 6(b) from the requirements of § 7. See, e.g., Washington Gas Light Co., Holding Company Act Release No. 1670, Aug. 2, 1939.
10. In most of the cases the Commission merely states that the record indicates that the issue complies with the provisions of § 7(d). Cases where the Commission has discussed the standards of § 7(d) (1) and (2) in detail include: Public Service Co. of Colo., Holding Company Act Release No. 1701, Aug. 24, 1939; pp. 30-34 [also § 7(d) (6)] (but cf. Commissioner Healy dissenting at p. 61 et seq.); and North. American Co., Holding Company Act Release No. 1427, Jan. 30, 1939, p. 24.
11. The dividend restrictions imposed by the Commission are discussed in Comment (1940) 49 YALE L. J. 492, 504 et seq.
13. See the statement of Commissioner Healy, dissenting in Public Service Co. of Colo., Holding Company Act Release No. 1701, Aug. 24, 1939, at 65: “Though under the Act the same standards are applicable to refunding issues as to new issues, I know that as a practical matter the standards are often relaxed in favor of refunding.”
in those cases unbalanced financial structures already exist, and since the
refinancing would tend to improve the structure by reducing fixed charges,
the Commission has contented itself with the imposition of conditions. Future
cases may present an even stronger reason for continued gentle treatment
of refundings; for when the bonds to be refunded have imminent maturities,
a denial of the right to sell refunding bonds might necessitate reorganization.

These special considerations, however, are not present when the purpose
of a security issue is not to refund but to raise "new" money. Cases in-
volving such new issues had been sparse and unenlightening until the advent
recently of the much-publicized Consumers Power case. Much of
the notoriety attending that case centers on the question raised under Section
7(d) (4) as to the reasonableness of the underwriters' fee and on the related
problem of the existence of arms-length bargaining between company and
banker. Far more significant, however, is the attitude taken by the Com-
mission toward the financial structure of the company and its right to issue
bonds. The Consumers Power Company, a financially sound operating utility
company within the jurisdiction of the Public Utility Holding Company Act,
had earned and paid dividends on its common stock for years. It proposed to
raise $33,000,000 — $29,500,000 by the sale of bonds at the unusually low
interest cost of 3%, reflecting a strong credit rating, and $3,500,000 by the
sale of common stock to its parent, which held all the outstanding common
stock. It was contemplated that the proceeds from the sale of the stock and
of $10,000,000 face value of the bonds would be used to finance new con-
struction; the balance of the proceeds of the sale of bonds to refund out-
standing bonds. The financial structure of the company consisted of 51%
bonds, 29% preferred stock and 20% common stock and surplus; the ratio of debt to net fixed assets was 55%, and only 11% of the amount of net fixed assets was available for common stock and surplus, after providing fully for debt and preferred stock.

A minority of the Commission was not unduly troubled by this financial structure; it felt that sufficient reason existed to grant permission to market the entire issue. The proportion of debt to assets was 55%, and the Commission, in other cases, had not stopped issues where far higher ratios existed. The 20% ratio of common stock and surplus to total capitalization, furthermore, appeared to be misleading; another 29% of capitalization comprised preferred stock. Though the preferred stock interest might be larger and the common stock interest smaller than was desirable, the disproportion was not such as to affect the bonds or lead to reorganization. To the minority these reasons justified a favorable finding under Section 7(d)(1); the unusually low rate of interest at which the bonds were to be sold also warranted a finding that the transaction was "economical and efficient" within the meaning of Section 7(d)(3).18

The majority of the Commission, however, speaking through Chairman Frank, reacted differently. It considered the relation of the bond issue to Section 7(d) twice, once for the bonds whose proceeds were to be used for refunding, and once for the "new construction" bonds. Of the refunding bonds the majority said, in line with the Commission's previous refunding decisions, and in the absence of any adverse showing in the record, that "the proposed issue . . . clearly meets the standards of Section 7(d)(1), (2), (3) and (6)."22 But the majority refused to permit the financing of new construction by bond sales. They assumed, without deciding, that this part of the issue met the terms of Section 7(d)(1) and (2). Their decision was based on a resort, for the first significant time, to Section 7(d)(3), under which the Commission cannot permit the issue of securities which it finds are not "necessary or appropriate to the economical and efficient operation of a business." Interpreting the phrase "necessary or appropriate" to mean that no other method of financing was "unquestionably better . . . and . . . easily available," the majority found that the bonds did not meet this standard. Common stock financing was regarded as "easily available," since the record established that at least one banker was willing to underwrite the sale of common stock and that the company had an excellent

17. On the issue of the $10,000,000 "new" bonds, the minority comprised Commissioners Healy and Matthews.
18. See the separate opinion of Commissioners Healy and Matthews, p. A-11 et seq.
19. On the issue of $10,000,000 "new" bonds the majority comprised Commissioners Frank, Henderson and Eicher.
20. All the securities proposed to be issued met the requirements of §7(c). Chairman Frank's statement, Opinion, at 13, that the common stock satisfied the requirements of §7(c)(1) should instead, have referred to §7(c)(2)(B), since the stock was no par. Cf. the separate opinion of Commissioners Healy and Matthews, p. A-1.
21. See note 34 infra.
22. Chairman Frank's opinion, at 15.
earnings and dividend record. Such financing was "unquestionably better" because, although the company's bond structure had not approached the danger point—to be tested under Section 7(d)(2) by available earnings—heed had to be taken of the unpredictable future when the company, in times of business stress, might require additional capital which could only be secured "if the corporation has not previously exhausted its credit by the issuance of bonds." Such additional capital, furthermore, when superimposed on the heightened debt-asset ratio resulting from the present financing, might then necessitate an adverse finding by the Commission under Section 7(d)(1). These general contingencies, when considered in conjunction with the existing financial structure of the company—in the analysis of which the majority categorized preferred stock with bonded debt—warranted an adverse finding under Section 7(d)(3).

Whatever the merits of the Commission's decision, its reasoning alters its previously expressed explanations of the respective purposes of subsections (1), (2) and (3) of Section 7(d). It is true that all the members of the Commission, despite their lack of unanimity on most of the issues in the case, agreed on the interpretation to be assigned to Section 7(d)(3). Nevertheless, from the point of view of orthodox statutory interpretation, the Commission's construction of the phrase "necessary or appropriate" included in subsection (3) appears strained. The phrase appears at least thirty-five times in varying contexts in the first twelve sections of the Act; moreover, the Commission's construction is not necessarily reinforced by the broader purpose of subsection (3). While the genesis of that subsection is obscure, its conceivable objectives may differ from those assigned to it by the Commission. It might have been designed to remedy a number of evils uncovered by the Federal Trade Commission, such as the issue of securities by an operating company when the funds raised were not to be used in the operation of the business but for some extraneous purpose. Perhaps, also, it was

24. Chairman Frank's opinion, at 19.
26. In view of the hasty and incomplete presentation of the case by the company, the Commission's application of Section 7(d)(3) to the facts [and possibly its interpretation of Section 7(d)(3)] may be revised upon more leisurely consideration. In an attempt to meet the underwriters' "deadline" date applicants brought the case on for oral argument before the evidence was fully heard. The Commission, therefore, has granted the parties as a matter of right for ten days, a rehearing on the $10,000,000 "new" financing question and agreed to reopen the record. This right was extended an additional ten days. Holding Company Act Release No. 1876, Jan. 10, 1940.
27. Some support for the Commission's interpretation may be derived from the emphasis placed by §7(d)(3) upon control of the "particular security".
28. See Fed. Trade Comm. Report on Economic, Financial, and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Sen. Doc. No. 92, Pt. 72-A, 70th Cong., 1st Sess. (1934) 358-9. Those pages disclosed the prevalent practice of the sale of bonds bearing fixed charges by operating companies solely to provide funds for the benefit of parent holding companies unable to raise the funds themselves and not for any legitimate operating need. The Holding Company Act was largely based on this report; it was thus stated in §1(b) of the Act. The Commission has other means to control this evil; §12(a) forbids upstream loans.
aimed at sales of securities to raise unneeded funds. Prior to the Consumers Power case, the Commission had not interpreted the subsection, except once where an applicant sought to change the terms of an issue after marketing to assist an underwriter to dispose of the issue.29 Since the company derived no benefit from the change, and actually would have incurred out-of-pocket expenses, the Commission held that subsection (3) barred the proposed change. This case lends credence to the belief that the subsection might have been designed to restrict the purposes for which financing might be undertaken, rather than to place limitations upon a particular type of financing as tending toward an unbalanced financial structure. The latter role appears from the face of the statute to have been assigned to Section 7(d) (1) and (2), a view of the statute which the Commission apparently had adopted in the refunding cases.30

The Commission's reasons for relying on a novel interpretation of subsection (3), rather than upon a forthright application of subsections (1) and (2) are an interesting subject for speculation. The choice may perhaps be traced to the deliberate failure of Section 7(d) to distinguish between refundings and new issues,31 and the desire of the Commission to continue to treat refundings differently from new issues. In previous refunding cases, the Commission had approved issues under subsection (1) in the face of capital structures more unbalanced than that of Consumers Power.32 The Commission may have hesitated to deny the Consumers Power application under that subsection, lest by a denial of permission it should cast doubt upon the soundness of its action in previous refunding cases, and thereby render uncertain the status of future refunding cases. The Commission may have thought that this difficulty would not be presented by an invocation of subsection (3). Under the majority's interpretation, the requirements of this subsection would be satisfied when debt financing was the "necessary"

30. See note 10 supra. This inference is particularly to be drawn from Public Service Co. of Colorado, Holding Company Act Release No. 1701, Aug. 24, 1939. There a small part of the issue was designed to raise new capital; the earning power was exceptionally strong. The Commission considered only §7(d)(1)(2) and (6), completely ignoring the possibilities of §7(d)(3).
31. The Holding Company Act, as introduced, expressly exempted refunding issues from the provisions of §7(d). Hearings before Committee on Interstate Commerce on S. 1725, 74th Cong., 1st Sess. (1935) 16, §7(e); Hearings before Committee on Interstate and Foreign Commerce on H. R. 5423, 74th Cong., 1st Sess. (1935) 8, §7(e). When finally enacted, the provision relating to refunding issues was inserted instead as a condition precedent to the application of §7(d). While this change may conceivably have been inadvertent, under orthodox canons of statutory interpretation, the change is regarded as a deliberate manifestation of Congressional intent.
32. The most striking instance is Public Service Co. of Colo., Holding Company Act Release No. 1701, Aug. 24, 1939. There the elimination of intercompany profits from the asset accounts revealed that each $1 of original cost of assets supported $1.01 of debt. Like Consumers Power, however, the earning power was strong. This case is discussed by Commissioners Healy and Mathews, pp. A-11-12. See Comment (1940) 49 Yale L. J. 492, 509; Central Illinois Gas & Electric Co., Holding Company Act Release No. 1592, June 19, 1939 (debt-asset ratio 107.8%).
method in the sense that equity financing was not available. Since the typical company seeking to refinance has no alternative but to refund by the sale of bonds, Section 7(d)(3) would be inapplicable.\textsuperscript{33} The Commission would then be free to judge refunding cases in accord with the precedents set up under subsections (1) and (2).

The Commission is, of course, justified in its attempt to treat refunding bond issues differently from those designed to raise new capital. But although the interpretation which it has placed upon subsection (3) will simplify the Commission's administrative problem in most of the cases which arise, annoying refunding-new issue problems will continue to present themselves. One such situation embraces refunding bond cases which subsection (3) would prohibit on the ground that common stock could be sold and bond financing would be inappropriate when judged by the standards of the \textit{Consumers Power} case. Since most companies would not refund unless permitted to do so with another bond issue, Commission disapproval would deprive them of the refunding advantages which the Commission previously has been so loathe to deny. Another problem would be presented when a bond issue to raise new money is proposed which the Commission may feel it must disapprove, despite the inapplicability of subsection (3) because common stock financing is unavailable. Such an issue must then be judged under the provisions of subsections (1) and (2). To approve the refunding issue under subsection (3) or disapprove the new money issue under subsections (1) and (2), the Commission would be compelled to decide that a different conclusion as to appropriateness [7(d)(3)] or reasonable adaptation to security structure [7(d)(1)] and earning power [7(d)(2)] might well be reached in the case of a refunding issue which cuts interest rates than would be reached in the case of a new issue. If such a new issue-refunding dichotomy may ultimately be required, the Commission might well have established it within subsections (1) and (2) in the \textit{Consumers Power} case, instead of delimiting, as it did, the possible future scope of subsection (3).\textsuperscript{34}

33. This conclusion is supported by the following statement of Chairman Frank: "However, if we find that the security is 'necessary,' the security would satisfy the standards of § 7(d)(3) that it be 'necessary or appropriate,' and we would not reach the question of whether it is appropriate. The clear language of the statute requires this result and leaves no room for the contention that this interpretation is incongruous in that a relatively weak company, because it is 'necessary' for it to sell the senior security, can more easily satisfy the statutory standard than a strong company, which is able to finance with alternative types of securities." Opinion of Chairman Frank, at 20.

34. Chairman Frank said that there was no showing that common stock financing was available or bond financing inappropriate with respect to the $18,500,000 refunding bonds. Opinion, at 18-19. This, however, may have been the short solution to an embarrassing problem. While the applicant, presumably, will resort to common stock financing to furnish capital required for new construction, normally it would not desire to sell common stock to refund bonds whose maturity is well-ahead. Had the Commission denied the right to refund by bond sales the declarant might have abandoned its refunding program and sacrificed the hoped-for advantages. It should be noted that the Commission has itself demonstrated that the present financial structure does not warrant bond financing within the standards of § 7(d)(3). Furthermore, it is stated that Otis & Co. had offered to market common stock of a minimum amount of $10,000,000. Opinion of Chairman Frank, at 20.
Irrespective of statutory niceties, the Commission's decision raises a serious question as to the wisdom of the majority's analysis of the capital structure of Consumers Power and poses some neat problems for prospective security issuers. The Commission's decision in the Consumers Power case is not to be construed as holding that, wherever possible, common stock financing should be utilized; instead it indicates that equity financing, when possible, will be required only when there is an unreasonable preponderance of securities other than common stock in the financial structure. The majority has treated bonds and preferred stock alike in making this determination. The existence of preferred stock in the financial structure, however, bears little relation to the safety of that structure. Accumulated arrearages on preferred shares cannot touch off reorganization processes, nor are managers under any compulsion to pay preferred dividends which might impair the liquid resources of the company. If the majority had classified preferred stock with the common, as did the minority, then the financial structure it would have faced would have comprised some 51% of outstanding bonds, instead of 80% bonds and preferred stock. Whether the Commission's decision would then have been different is unpredictable, but in view of the majority's attitude toward preferred stock it is also academic.

Prospective issuers, however, must speculate how much lower must be the ratio of bonds and preferred stock to total capitalization to avoid the pitfalls of Section 7(d)(3). Uncertain, also, is the extent of the record which the Commission will require before finding that common stock sales are feasible. Future decisions may not be as simple as was that in Consumers Power, where the testimony of an underwriter that he could sell such stock stood uncontroverted. Not only will clannish underwriters hesitate thus to aver, but issuers and their bankers may introduce contrary testimony. The Commission may be obliged to rely on such external indicia as earning power or available cash of a possible parent company. Should the Commission's conclusion on the availability of common stock financing prove erroneous, the operating program of the applicant might be seriously handicapped.

There can be no quarrel with the basic principle behind the Commission's decision; a policy and practice which went further and required that all financing be accomplished by common stock would be entirely defensible from the sole standpoint of investor protection. It is to be hoped, however, than in its eagerness to afford full protection to investors from the perils of unbalanced capital structures, the Commission will not require unnecessary protection and thus create unwarranted obstacles to desirable utility.

35. It is well settled that a debtor-creditor relationship is not created until the dividend has been declared. Alexander & Alexander, Inc. v. United States, 22 F. Supp. 921 (D. Md. 1938). Directors have broad discretion as to the declaration of dividends. Beale and Means, The Modern Corporation and Private Property (1932) 189-90. Though reorganization may not be forced by excessive preferred stock structure, however, such structure may imperil credit and the ability to sell common stock.

36. On the desirability of greater common stock financing see Frank, Save America First (1938) 385; Moore, Railroad Fixed Charges in Bankruptcy Proceedings (1939) 47 J. Pol. Econ. 100, 107-15.
expansion or construction programs. Whether the Commission has under-
protected or overguarded the investors in Consumers Power is to be tested 
solely by the future experience of investors in that company. It has been 
suggested that the principles of regulation enunciated in the Holding Company 
Act, if successful there, will become a pattern for Governmental action in 
other fields of investment.\textsuperscript{37} Judgment as to the wisdom of such enlarged 
legislation awaits more extensive experience in the limited field regulated 
by the Public Utility Holding Company Act.

LIABILITY OF UNION TO EMPLOYEES DISCHARGED AS RESULT OF 
CLOSED SHOP AGREEMENT*

While tort liability is conceded to follow intentional interference with an 
existing contract or employment relation in the absence of sufficient "justifi-
cation" for such interference,\textsuperscript{1} the attitude of courts has widely varied in 
applying this indeterminate rule to litigation arising from an attempt by a 
labor union to secure a closed shop.\textsuperscript{2} Although there have been comparatively 
few cases in which suit was brought by an employee who had been discharged 
as a consequence of a closed shop agreement, the related issue of the remedies 
available to an employer in his resistance to the union's demand frequently 
rests on judicial speculation as to the effect of the closed shop on the welfare 
of the non-union employee.\textsuperscript{3} Assuming without inquiry that other work is

\textsuperscript{37} Commissioner Frank, dissenting in North American Co., Holding Company Act 


1. For a thorough discussion of the rule and its history, see Carpenter, \textit{Interference 
with Contract Relations} (1928) 41 \textit{Harv. L. Rev.} 728. The \textit{Restatement of Torts} 
provides: "... One who, without a privilege to do so, induces or otherwise purposely 
causes a third person not to (a) perform a contract with another, or (b) enter into or con-
tinue a business relation with another is liable to the other for the harm caused thereby." 
\textit{Restatement, Torts} (1939) § 766. Also, see § 810, set forth at note 12 infra. Actual 
malice is not essential to the cause of action; the absence of lawful excuse or justification 
is enough. Campbell v. Gates, 236 N. Y. 457, 141 N. E. 914 (1923). If malice can be 
proved, punitive damages may be allowed. Kinane v. Fay, 111 N. J. L. 553, 168 Atl. 724 
(Sup. Ct. 1933).

2. For a general discussion of the decisions, see Magruder, \textit{A Half Century of Legal 
Influence Upon the Development of Collective Bargaining} (1937) 50 \textit{Harv. L. Rev.} 
1071; Witmer, \textit{Collective Labor Agreements in the Courts} (1938) 48 \textit{Yale L. J.} 195;

3. Folsom Engraving Co. v. McNeil, 235 Mass. 269, 126 N. E. 479 (1920); International Ticket Co. v. Wendrich, 122 N. J. Eq. 222, 193 Atl. 808 (Ch. 1937); Cooks', 
1921). In a recent case, the defendants were convicted of a criminal conspiracy under a 
Maine statute, for agreeing to conduct a strike for a closed shop, State v. Mackey, 135 
Me. 488, 200 Atl. 511 (1938), \textit{appeal dismissed}, 305 U. S. 570 (1938) (want of "a properly 
presented substantial federal question"), \textit{rehearing denied}, 305 U. S. 675 (1938), 
unavailable and that the employees of a particular plant are necessarily antagonistic to unionism, many courts in the past have declared that picketing, boycotts and strikes are unlawful when directed towards securing an agreement with an employer to retain or hire only union men. These activities have been disapproved as interferences with the "liberty" of the individual, imposing the "unwarranted" condition that he join a union in order to pursue his vocation. But an increasing number of courts are now willing to recognize that an attempt by a union to obtain a closed shop contract may be justified as a legitimate method of enlarging union membership and strengthening the bargaining power of organized labor. Union activity to secure a closed shop agreement may be justified even when another union already has such a contract, since its existence does not necessarily insure that the workers are adequately represented by an efficient collective agency.

Some courts have been content to condemn closed shop agreements on the theory that such contracts "tend" to promote a monopoly of the labor market by excluding from employment all those who do not belong to the union. In other decisions, a distinction has been drawn between an attempt to secure a closed shop in a single factory or in a small group of factories and an attempt to secure the closed shop in substantially an entire industry in a particular area. This distinction is unsatisfactory and has received

4. See cases cited supra note 3. The statement of the court in Cooks', Waiters' and Waitress' Local Union v. Papageorge, 230 S. W. 1086, 1088, 1059 (Tex. Civ. App. 1921) is typical: "The Constitution grants to every man, under the protection of the American flag, the right to make contracts for his personal services, free from hindrance or obstruction by his fellow men, and he has the inalienable right to freely use his hands for whom he pleases, upon such terms as he pleases."

5. Exchange Bakery & Restaurant v. Rifkin, 245 N. Y. 260, 157 N. E. 130 (1927); Williams v. Quill, 277 N. Y. 1, 12 N. E. (2d) 547 (1938), appeal dismissed, 303 U. S. 621 (1938); Four Plating Co. v. Mako, 122 N. J. Eq. 298, 194 Atl. 53 (Ch. 1937). In M & M Wood Working Co. v. Plywood & Veneer W. L. U. No. 102, 23 F. Supp. 11, 18 (D. Ore. 1938), the court said: "This type of agreement is sanctioned by the historical development of the labor movement as one of the most valuable guarantees of economic freedom of the workingman. The decisions of the courts recognize this fact."

6. Stillwell v. Kaplan, 259 N. Y. 405, 182 N. E. 63 (1932), discussed with approval in Jaffe, Inter-Union Disputes in Search of a Forum (1940) 49 Yale L. J. 424, 450. Stillwell v. Kaplan is not the prevailing view, however. See Despres, supra note 2, at 44. For the effect of the Labor Relations Acts on the closed shop, see ibid.; Abelow, The Closed Shop in New York (1938) 7 Brooklyn L. Rev. 459, 476, 477; Comment (1938) 38 Col. L. Rev. 1243, 1247. As to union liability for inducing the breach of a "yellow dog" contract, see Comment (1938) 32 ILL. L. Rev. 611, 617.

7. Berry v. Donovan, 188 Mass. 353, 74 N. E. 603 (1905); Curran v. Galen, 152 N. Y. 33, 46 N. E. 297 (1897). "Public policy and the interests of society favor the utmost freedom in the citizen to pursue his lawful trade or calling, and if the purpose of an organization or combination of workingmen be to hamper, or to restrict, that freedom . . . , then that purpose seems clearly unlawful and militates against the spirit of our government and the nature of our institutions . . . ." Id. at 37, 46 N. E. at 298. For the present New York rule, see note 13 infra.

8. Connors v. Connolly, 86 Conn. 641, 86 Atl. 600 (1913); Four Plating Co. v. Mako, 122 N. J. Eq. 298, 194 Atl. 53 (Ch. 1937); Canter Sample Furniture House v. Retail Furniture Emp. Local, 122 N. J. Eq. 575, 196 Atl. 210 (Ch. 1937); Upholsterers'
confused application in the cases. One court refused to enforce a closed shop contract in a district in which sixty-five per cent of the employers in an industry had such contracts. In the same jurisdiction, although nearly fifty per cent of an industry had such agreements, a strike for a closed shop was sanctioned. The criterion of the proportion of the industry covered by closed shop contracts allows too much latitude to an unsympathetic court to make a finding of "intent" to monopolize. Flimsy evidence has sustained the conclusion that a strike in question was "part and parcel of an attempt to unionize the entire . . . industry" in a city, the court stating that it was impossible to consider the attempt to unionize a single shop or place of business in "isolation from the wave of strikes and labor controversies sweeping the country . . . ."

The test of union liability for enforcing a closed shop agreement, which few cases have recognized but which seems most consistent with the promotion of the interests of labor as a whole and the protection of the individual worker, is whether admission to the union is permitted to existing employees on reasonable terms. Public policy should not be concerned with the extent of the closed shop agreement, for if adequate provision is made for the pro-


10. Four Plating Co. v. Mako, 122 N. J. Eq. 298, 194 Atl. 53 (Ch. 1937).

11. Canter Sample Furniture House v. Retail Furniture Employees Local, 122 N. J. Eq. 575, 592, 196 Atl. 210, 218 (Ch. 1937). The court stressed the fact that another retail furniture dealer had filed a similar bill of complaint against the union.

Another unsatisfactory distinction sometimes made in the decisions is that if the "primary aim" of the union was to injure or exclude from their work men who are not members of the labor organization, its action is unlawful, whereas if its object is "merely" to procure work for those who are members, injury to the non-union workman being "incidental," it will not be liable for inducing the breach of the employment contract. Obviously, in nearly every case, the motive which must meet the test of justification is nearly the same: to insure that all the workmen in the particular shop will be union men. See Despres, supra note 2, at 36.

12. The Restatement of Torts provides: "Workers who in concert procure the dismissal of an employee because he is not a member of a labor union satisfactory to the workers are . . . liable to the employee if, but only if, he desires to be a member of the labor union but membership is not open to him on reasonable terms." Restatement, Torts (1939) § 810. Cj. id. § 788. See Witmer, supra note 2, at 219. In Frankel, One Hundred and Fifty Years of the Bill of Rights (1939) 23 Minn. L. Rev. 719, 767, it is said: "Clear it is that if closed shop agreements are to be recognized, the union must admit all qualified persons to membership." Courts have been favorably influenced in their decisions by the willingness of the union to take in men affected by the closed shop contract. See Shinskey v. O'Neil, 232 Mass. 99, 104, 121 N. E. 790, 792 (1919) ; Mills v. U. S. Printing Co., 99 App. Div. 605, 613, 91 N. Y. Supp. 185, 190 (2d Dep't 1904). In two states where an attempt by a union to secure a closed shop has been otherwise upheld, the union has been liable to discharged workers whom they unreasonably refused to admit to the union. Wilson v. Newspaper & Mail Deliverers' Union, 123 N. J. Eq. 347, 197 Atl. 720 (Ch. 1938), 23 Minn. L. Rev. 236; Dorrington et al. v. Manning, 135 Pa. Super. 194, 4 A. (2d) 886 (1939).
tection of the employees it affects, such a “monopoly of the labor market” is beneficial, rather than harmful. Actually, the purpose of the closed shop contract is almost always to induce employees to join the union rather than to place other men in their jobs. The concessions secured from an employer by union activity redound to the benefit of all workers in his plant. It is accordingly not unreasonable to demand that they become members and contribute to the support of the union. Since improved working conditions cannot ordinarily be maintained in but part of a competitive industry, the union is justified in its attempt to unionize every factory in a particular trade.

On the other hand, if admission to the union is unreasonably denied to one who is thereafter discharged in consequence of a closed shop agreement, the union should be held liable regardless of whether the closed shop agreement is made with a single employer or with a group, in a small or large part of an industry. Such, in effect, was the holding of a recent Pennsylvania case, in which the court stated that the conduct of the defendant union in coercing the employer to discharge the plaintiffs, who had been arbitrarily refused admission to the association, “constituted a malicious and willful interference with plaintiffs’ contract of employment and a conspiracy to do an unlawful act.” The plaintiffs were awarded damages for loss of wages.


14. The agreements frequently provide that they are to operate only prospectively or that all employees will be admitted to the union. See LIEBERM, THE COLLECTIVE LABOR AGREEMENT (1939) 202; Polk v. Cleveland Ry., 20 Ohio App. 317, 151 N. E. 803 (1925); Mills v. U. S. Printing Co., 99 App. Div. 695, 91 N. Y. Supp. 185 (2d Dca’t 1904).

15. If the employee were able to secure the benefits of the union without the burden, members would tend to drop out and the organization would become ineffective. This argument has been used by Brandeis. See FRAENKEL, THE CURSE OF BIGNESS (1934) 93 et seq.

16. “All engaged in a trade are affected by the prevailing rate of wages. All, by the principle of collective bargaining. Economic organization today is not based on the single shop. Unions believe that wages may be increased, collective bargaining maintained only if union conditions prevail, not in some single factory but generally. That they may prevail it may call a strike and picket the premises of an employer with the intent of inducing him to employ only union labor.” Exchange Bakery & Restaurant v. Rifkin, 245 N. Y. 260, 263, 157 N. E. 130, 132 (1927). See American Foundries v. Tri-City Council, 257 U. S. 184, 209 (1921); Williams v. Quill, 277 N. Y. 1, 10, 11, 12 N. E. (2d) 547, 550, 551 (1938).

17. See note 12 supra.

18. Dorrington et al. v. Manning, 135 Pa. Super. 194, 199, 4 A. (2d) 885, 889 (1939). The union gave no reason for excluding plaintiffs from membership. The court incidentally approved the finding below that the collective bargaining agreement was executed on the understanding that all existing employees would be admitted to membership in the union.
and an injunction restraining defendants from interfering with their resumption of employment. The justification which ordinarily exists for a union's interference with established employment relations, in its demand for a closed shop, is obviously lacking in a case like the one in question, when the object of the action is not to strengthen collective bargaining, but simply to promote the interests of a particular group to the detriment of a disfavored few.

In issuing an injunction, which seems to be an appropriate remedy in this case, the court necessarily rejected the argument that the anti-injunction statutes were applicable. It is true that these statutes expressly cover a dispute in which the parties are not in the proximate relation of employer and employee, but they are inapplicable altogether except to "labor disputes" or controversies concerning "terms or conditions of employment." The instant case involved a private dispute which was in no way connected with the respective interests of employer and employee, terms or conditions of employment or the question of the proper employees' bargaining agency.

The union would, of course, have a defense in the worker's opportunity to mitigate damages, if they could prove that it was possible for him to find equivalent employment at a reasonable distance from his home. The union should also have the privilege of demanding that the worker properly qualify as a member. This privilege, however, should not relieve the union of liability for securing the dismissal of a worker, if he has been denied entrance into the union as a result of an unreasonable test or restriction. Moreover, union liability should not be affected by the circumstance that the employment

19. A similar remedy was granted in Wilson v. Newspaper & Mail Deliverers' Union, 123 N. J. Eq. 347, 197 Atl. 720 (Ch. 1938). The plaintiffs have been guilty of no misconduct, the issuance of an injunction will involve relatively little hardship to the defendants, and a multiplicity of suits will be avoided thereby.

20. For a discussion of the Norris-LaGuardia Act and similar state acts, see Comment (1940) 49 YALE L. J. 537; (1938) 23 CORN. L. Q. 339; (1939) 25 VA. L. REV. 719.

21. It is important, of course, that these statutes be liberally construed by the courts to protect the rights of labor. The present case, however, amounts to no more than a fight among individuals to secure certain employment. The case is analogous to La Rose v. Possehl, 156 Misc. 476, 282 N. Y. Supp. 332 (Sup. Ct. 1935), in which the court held that a dispute between a union and the plaintiff as to whether he was entitled to be recognized as a member was not a "labor dispute" within the meaning of the term in the statute. The court was influenced by the fact that under the statutory provision it was necessary to post a bond of $10,000 as a prerequisite of obtaining a temporary injunction in a "labor dispute."


23. The courts have indicated that the union may validly require its applicants to attain to certain technical standards. Clemmitt v. Watson, 14 Ind. App. 38, 42, 42 N. E. 367, 368 (1895); National Protective Ass'n v. Cummings, 170 N. Y. 315, 323, 63 N. E. 369, 370 (1902). The union is also privileged to procure the dismissal of a worker who has been justly expelled from the union. Harmon v. United Mine Workers, 166 Ark. 255, 266 S. W. 84 (1924); Roddy v. United Mine Workers, 41 Okla. 621, 139 Pac. 126 (1914). Contrary: Connors v. Connolly, 86 Conn. 641, 86 Atl. 600 (1913).

24. The courts would probably condemn an unreasonably high or unequal initiation fee.
was at will, although some courts have stated that in such a case no action will lie unless the method of interference itself was tortious. The mere fact that the employer has the privilege of terminating such employment for any cause whatsoever does not carry the implication that the employee should be unprotected against a third party who unjustifiably influences the employer in his exercise of privilege. If the employee is a competent workman who is willing to become a member, the union rarely can justify its interference with his employment relations.

When no existing employment relation is disturbed, but a worker cannot find a job because the union arbitrarily refuses to admit him to membership, the courts have been slow to protect the interests of the non-union man. Although a remedy is available to a member who has been wrongfully expelled, a writ of mandamus will not issue to compel a voluntary association to admit an applicant to membership. Thus the worker cannot by suit directly force his way into the organization, but possibly by means of an indirect sanction, the union may be constrained to allow him to join or to have its closed shop program partially defeated. The courts should

25. See Carpenter, supra note 2, at 763; Despres, supra note 2, at 34; RESTATEMENT, TORTS (1939) § 810, quoted supra note 12.

26. "There can be no damages resulting to an employee on account of a discharge from an employment at will." Harmon v. United Mine Workers, 166 Ark. 255, 258, 255 S. W. 84, 85 (1924).

27. Railway Conductors v. Jones, 78 Col. 80, 239 Pac. 832 (1925); Lucke v. Clothing Cutters, 77 Md. 396, 26 Atl. 505 (1893).

28. Proof of hostility to union purposes would probably be considered the only grounds of justification. Evidence of a previous refusal to join the union has been considered insufficient reason to deny membership to an applicant and to procure his dismissal from his employment. Dorrington v. Manning, 135 Pa. Super. 194, 4 A. (2d) 235 (1939).

29. Underwood v. Texas & P. Ry., 178 S. W. 38 (Tex. Civ. App. 1915). Even when it is shown that the association has a monopoly of work in a given area, the cases seem to turn on whether the plaintiff was dismissed or merely could not find employment because of a closed shop agreement. Witmer, supra note 2, at 213, 214.

30. See discussion in Jaffe, supra note 6, at 445.

31. Mayer v. Journeymen Stonemasons' Ass'n, 47 N. J. Eq. 519, 20 Atl. 492 (Ch. 1890); Legis. (1940) 53 HARV. L. REV. 500, 501. The court in Mayer v. Journeymen Stonemasons' Ass'n, 47 N. J. Eq. 519, 524, 20 Atl. 492, 494 (Ch. 1890), stated: "The very idea of such organizations is association mutually acceptable . . . a power to require the admission of persons in any way objectionable to the society is repugnant to the scheme of its organization."

32. The courts in both Wilson v. Newspaper & Mail Deliverers' Union, 123 N. J. Eq. 347, 197 Atl. 720 (Ch. 1938) and Dorrington v. Manning, 135 Pa. Super. 194, 4 A. (2d) 886 (1939) allowed damages and an injunction against unions which unreasonably refused to admit to membership workers who had been discharged as a consequence of a closed shop agreement. The Wilson case applied the analogy of a common carrier whose duty to serve all comers on reasonable terms is imposed because of the monopoly it possesses. The court stated: "A union may restrict its membership at pleasure; it may, under certain conditions, lawfully contract with employers that all work shall be given to its members. But it cannot do both." 123 N. J. Eq. 347, 351, 197 Atl. 720, 722. The same rationale may be used for the protection of a worker who has been refused a particular job.
hold that a good cause of action is stated, if it is alleged that the plaintiff definitely would have been able to secure a job with a particular employer, had he been admitted to a union which arbitrarily rejected his application for membership. A worker’s reasonable expectation of employment may well be considered a sufficient interest to be protected against unjustifiable interference by third parties. In such a situation, if a non-union employee is hired, he should not be held liable for inducing the employer to breach his closed shop agreement, since enforcement of the contract when union membership is not freely available contravenes public policy in that it unduly restricts the employment opportunities of non-union men without benefitting labor as a class.

It may be necessary in the future to utilize an administrative agency to protect the non-union man who cannot procure a job because he is arbitrarily excluded from a union; unemployed, he probably cannot bear the expense of litigation. Recent statutes in two states have helped to insure that all employees affected by a closed shop agreement will be admitted to union membership, but no state has taken upon itself the regulation of union admissions. It is clear, however, that the danger of abuse of monopolistic power on the part of unions is small. In most industries, their positions are insecure, and even when they exercise control over a large industry, their policies of admission are liberal. If the danger arises, it can easily be met, but the doubtful possibility of future abuse of power on the part of unions should not be regarded as a sufficient defense for obstructing the growth of the closed shop.

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for no other reason than his lack of membership in a union which has a monopoly of work in a particular district and unreasonably denies him admission to its organization.

33. The chapter of the Restatement of Torts dealing with labor disputes has no rule for this situation, but the general principle set forth in § 766, cited supra note 1, seems to cover such a case.

34. Restatement, Contracts (1932) § 513; Restatement, Torts (1939) § 774; see Illustration (1) in § 18 of Proposed Final Draft No. 6 (1939).

35. Pa. Stat. Ann. (Purdon, Supp. 1939) tit. 43, § 211.6(1)(c) (June 1939); Wis. Laws 1939, c. 57. Both statutes are amendments to the respective state labor relations acts and are designed for the protection of employees affected by a closed shop contract. The Pennsylvania statute fails to allow a union to deny membership to a man for good cause, but otherwise these enactments are commendable as consistent with the best interests of the individual and of the union. Cf. Legis. (1940) 53 Harv. L. Rev. 500.

36. Attempts have been made to prevent racial and religious discrimination on the part of unions. Comment (1939) 39 Col. L. Rev. 986, 995, 996. State regulation of union admissions is clearly ill-advised and should not be attempted in the absence of serious abuses of widespread consequence.

37. See Despres, supra note 2, at 29, 30.
COOPERATIVE BUYING OF GASOLINE AS SHERMAN ACT VIOLATION *

"Cooperation" and an allied group of catchwords have loomed large in the recent vocabulary of the oil industry. "Cooperation" has been the means for cutting down the supply of petroleum through "conservation," for avoidance of "economic waste" through allocation of production, for assuring a fair return to the industry through "stabilization," for sharing technical advantages among eligible members of the industry, and for eliminating "cutthroat competition" through mutual respect for marketing territories and existing price levels.¹ An overdose of "cooperation" has occasionally brought the industry into conflict with the anti-trust laws.² A prosecution under Section 1 of the Sherman Act,³ now pending before the United States Supreme Court, questions the propriety of "cooperation" in eliminating a "competitive abuse."⁴

Defendants in the case are a dozen "majors" or "integrated oil companies," so called because of their economic pre-eminence in the industry and because their enterprise encompasses all stages of the business from drilling oil wells to wiping windshields. In 1935 they were asked by the Petroleum Administration of the NRA to assist in stabilizing retail gasoline markets in a ten-state midwestern area in which the major companies manufactured and distributed more than 85% of all the gasoline sold.⁵ Chief cause of low retail prices was the presence of so-called "surplus" gasoline: that part of the production of independent non-integrated refiners in the oil fields for which they had no ready customers and which they were obliged to sell for what it would bring. In an attempt to dry up this supply at its source, defendants extended their stabilization activities to the refineries by means of concerted programs for keeping "surplus" off the market. Field investigators determined which refineries had "surplus" on their hands. A major company was then assigned to "dance" with each independent—to buy up all the excess gasoline.

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⁵ 105 F. (2d) 809 (C. C. A. 7th, 1939), cert. granted, 60 Sup. Ct. 124 (U. S. 1939).
The significance of this cooperative venture lay in the peculiar price customs of the area. Although less than 10% of the gasoline distributed in the area originated in the "spot market" (not an organized exchange but the composite of current transactions at oil field refineries), all gasoline prices in the area depended upon the spot market price as reported in trade journals. Retail and tank-wagon prices were adjusted by the area's market leader, Standard Oil of Indiana, to preserve a fixed margin over the reported spot market price, and some 40% of the gasoline sold in the area by the majors was purchased by independent jobbers on long-term contracts which uniformly provided that the price to be paid for each shipment of gasoline was to be determined by the spot market price at the date of each purchase. By absorbing a small amount of gasoline and thereby buoying up the spot market price, the defendant major companies were able to prevent the dropping of prices to competitive levels throughout the industry. That the companies acted in concert and that the programs affected price levels was not denied. Defendants were found guilty of combining in restraint of trade, under a charge by the trial judge that, if the defendants had the power to raise gasoline prices and combined for that purpose, their conduct was in itself unlawful. The charge accorded with the government's presentation of the case along the lines of United States v. Trenton Potteries Company which held that a combination by 82% of an industry to fix prices was per se an illegal restraint of trade under the Sherman Act.

On appeal, the Seventh Circuit Court of Appeals ordered a new trial on the ground that the jury should have been permitted to consider the defenses invoked by the majors in extenuation of their conduct. The defendants claimed that "surplus" gasoline was a recognized "competitive abuse," an unnatural depressant of the market whose elimination would restore true competitive conditions and excuse any incidental effects upon price levels. The majors relied heavily upon Appalachian Coals, Inc. v. United States which had permitted cooperative marketing of "distress coal," a misfit by-product whose unsalability had contributed to the troubled state of the coal industry. This case, they claimed, modified Trenton Potteries to permit

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6. Record on appeal, pp. 369-442, 1166-1208, 1689-1706. The "dancing partner" system was employed only in the mid-continent oilfield but comparable purchases from independent refiners were carried on simultaneously in the East Texas field; id. at 567-594, 623-670.

7. Id. at 189, 244, 797-99, 1004-05 (spot market); id. at 251, 290, 1233-35 (fixed margin prices); id. at 999-1000, 3031-42 (jobber contracts). Defendant Sinclair Refining Co. did not base jobber contracts upon the spot market price; id. at 340. The practice of basing other prices upon the spot market price long antedated the present combination. See F. T. C., PETROLEUM INDUSTRY, PRICES, PROFITS AND COMPETITION (1928) 214-218; BURNS, THE DECLINE OF COMPETITION (1936) 97.


combinations to affect prices incidentally in the cause of eliminating a “competitive abuse.” Trenton Potteries and its predecessor cases were distinguished as forbidding price-fixing but not “stabilization,” and as proscribing only compulsory combinations of those groups which, through control of an essential portion of a product, have the power to eliminate competition. Defendants also claimed that in removing “surplus” from the market, the majors were implementing a Governmental policy of raising gasoline prices to restore them to a profitable relationship with the price of crude oil fixed by the Petroleum Administration. They showed, in support of this, that minor officials of the Petroleum Administration knew and tacitly approved of the buying programs, and acquiesced in their continuance after the collapse of NRA. Although they claimed no exemption from the anti-trust laws, the majors bitterly protested the unfairness of being prosecuted for participating in activities originally sponsored by the Government.

If the defendants’ disclaimers of any intent to profiteer, their protests that their only motive in conducting the buying programs was that of cooperating with NRA in “bailing out” the independent refiner, and their glib characterization of surplus gasoline as a “competitive abuse” be taken at face value, as apparently the circuit court took them, the oil companies appear in the martyred light of being prosecuted for their patriotic efforts in aid of a national recovery program. Fairmindedness, it then seems, calls for rejecting the categorical approach of Trenton Potteries in favor of a “rule of reason” which would permit the jury to consider all these ameliorating factors. An examination of the defendants’ activities in the light of the structure and recent competitive history of the oil industry, however, presents the programs in a somewhat broader perspective than that adopted by the circuit court.

Among industries, oil is unique in being highly competitive at its production and distribution ends but almost devoid of price competition in its intermediate stages of refining and pipe line transportation, where the score or so of major companies are securely entrenched. Through their control of 83.8% of refining production, 89% of crude oil trunk pipe line mileage and 96% of gasoline pipe line mileage, and their monopolies of the Ethyl and cracking process patents, the majors are able to exact toll from the vast proportion of the nation’s oil which, almost inevitably, must pass through their hands at some stage in its journey from some 350,000 oil wells to an

12. Brief of Defendants-Appellants, 129-31, United States v. Socony Vacuum Oil Co., 105 F. (2d) 809 (C. C. A. 7th, 1939); id. at 822-23. The “compulsory combination” argument was raised gratuitously by the court; id. at 821.
15. 6 TNEC, VERBATIM RECORD OF PROCEEDINGS (1939) 4, 87-97.
almost equal number of service stations.\textsuperscript{17} Heavy profits from pipe line operation have been used to subsidize expansion into the production and marketing fields\textsuperscript{18} to make the majors dominant factors in all parts of the industry. Through their control of two thirds of the industry's wealth, their huge volume of purchases and sales and their leadership in the industry's trade association and propaganda activities,\textsuperscript{19} the majors are virtually able to speak for the industry itself. Although nominally rivals, the integrated companies have been drawn into unified activity—partly through common or similar origin, partly through interlocking ownership and affiliates,\textsuperscript{20} but principally through the community of interest which arises among large industrial units when each respects the power of each of his competitors over the market and appreciates the devastating consequences of earnest price competition between such huge companies.\textsuperscript{21} As a result, instead of price competition, there is between the major companies a "follow the leader" policy whereby all major company prices—the purchase price for crude oil, pipe line tariffs, tank-car, tank-wagon and retail gasoline prices—follow exactly the price policy of a market leader, which almost invariably is the local Standard Oil Company.\textsuperscript{22} Any competition that exists is on a superficial non-price level—directed toward advertising and lavishness of marketing equipment rather than toward public benefit from lowered prices.\textsuperscript{23}

\textsuperscript{17} See 6 TNEC, Verbatim Record of Proceedings (1939) 88, 626; National Bureau of Economic Research, Price Research in the Steel and Petroleum Industries (1939) 90-91.


\textsuperscript{20} F. T. C., Petroleum Industry, Prices, Profits and Competition (1928) 63-81; 6 TNEC, Verbatim Record of Proceedings (1939) 87, 275-278; Kemnitzer, Rebirth of Monopoly (1938) 42, 43.


Although oil refining and transportation have been featured by monopolistic practices since their infancy,\textsuperscript{24} it was only when the majors' oil inventories, greatly expanded in the belief that America's underground resources soon would be depleted,\textsuperscript{25} were imperilled by the discovery of unexpected large oil fields by independent operators in 1926 and 1930,\textsuperscript{20} that the \textit{credo} of monopolism, the preservation of price levels by cutting down supply, became the industry's gospel. The religion of "cooperation" made its appearance with appeals to drillers to curtail production.\textsuperscript{27} When these failed, the respectable elements in the industry turned to the states with pious urgings of the need for "conservation" of underground resources.\textsuperscript{28} The emotional content of the word "conservation" evoked great public sympathy, although the arguments supporting the principle were based upon frequently disproved geological evidence.\textsuperscript{29} That the industry's interests were not wholly that of preserving the national oil supply is shown by its concurrent lobby for a protective tariff against imports of foreign oil.\textsuperscript{30} The economic motives that lay behind "conservation" became apparent in 1931 when martial law was invoked in Texas and Oklahoma to shut down production until the price of crude oil rose from 20 cents to $1 per barrel.\textsuperscript{31} The emphasis upon price was explained by the statement that curbing "economic waste" was as important as preventing physical waste.\textsuperscript{32} Military control was followed by statutes

\textsuperscript{24} Stocking, \textit{The Oil Industry and the Competitive System} (1925) 15-18; Watkins, \textit{Oil: Stabilization or Conservation?} (1937) 22.

\textsuperscript{25} Kemnitzer, \textit{Rebirth of Monopoly} (1938) 51; Watkins, \textit{Oil: Stabilization or Conservation?} (1937) 43. Compare 1926 and 1938 oil inventory figures, 6 TNEC, \textit{Verbatim Record of Proceedings} (1939) 89, with corresponding consumption figures, \textit{id.} at 53.

\textsuperscript{26} 6 TNEC, \textit{Verbatim Record of Proceedings} (1939) 229.

\textsuperscript{27} See Watkins, \textit{Oil Stabilization or Conservation?} (1937) 43, 45; Marshall and Meyers, \textit{Legal Planning of Petroleum Production: Two Years of Proration} (1933) 42 \textit{Yale L. J.} 702, 708, n. 19.


\textsuperscript{29} The question of the exhaustibility of our petroleum resources within an appreciable time, fundamental to any evaluation of production control, remains unsettled. Despite increasing production virtually every year since 1914, estimates of petroleum reserves are now higher than ever before. 6 TNEC, \textit{Verbatim Record of Proceedings} (1939) 80. A restless technology has recovered an increased yield of gasoline from each barrel of crude oil, plumbed strata once regarded as inaccessible and struck oil in areas deemed sterile. \textit{id. at} 400-02, 597. Substitutes for petroleum are under development. \textit{Hearings before a Subcommittee of the Committee on Interstate and Foreign Commerce on H. R. 4547}, 76th Cong., 1st Sess. (1939) 99-100; see Pettengill, \textit{Hot Oil} (1936) 19-26.

\textsuperscript{30} See 47 \textit{Stat.} 260, 266 (1932); Kemnitzer, \textit{Rebirth of Monopoly} (1938) 128, 134; Pettengill, \textit{Hot Oil} (1936) 54. The tariff then imposed upon Venezuelan crude oil has recently been halved. \textit{N. Y. Times}, Nov. 7, 1939, p. 6, col. 1.

\textsuperscript{31} Marshall and Meyers, \textit{Legal Planning of Petroleum Production: Two Years of Proration} (1933) 42 \textit{Yale L. J.} 702, 716-26.

\textsuperscript{32} \textit{Id.} at 711.
prorating oil production among the oil wells of a state, although unitary pool operation would have been more consistent with principles of real oil conservation. At the other end of the industry, attempts were made at "cooperative market stabilization."35

"Cooperation" as a mask for self-interest attained full bloom with the advent of NRA.36 Section 9(c) of the National Recovery Act assured federal reinforcement of state proration statutes,37 while the Petroleum Code, which was largely devised and administered by the controlling interests in the industry, set up mechanisms for limiting imports, curtailing withdrawals of crude oil from storage, and fixing crude oil and gasoline prices.38 The market-rigging activities in the instant Socony-Vacuum case were the result of an opportunistic seizure of a maladjustment in the Code's administration. The distress position of the independent refiner which forced him to dump his "surplus" on the spot market resulted from the pegging of crude oil from 44 cents to the inordinate price of $1 a barrel.39 When the price of gasoline

33. Id. at 728; Lesar, Public Control of the Oil Industry (Unpublished thesis in Yale Law School Library, 1937) 38. State proration statutes are summarized in 1 SUMMERS, OIL AND GAS (1939) 218-273.
34. See MID-CONTINENT OIL AND GAS ASSOCIATION, HANDBOOK ON UNITIZATION OF OIL POOLS (1930) 52 et seq.; Marshall and Meyers, Legal Planning of Petroleum Production (1931) 41 YALE L. J. 33, 59-63. The major companies have recently favored unitization. 6 TNEC VERBATIM RECORD OF PROCEEDINGS (1939) 245-47.
37. 48 STAT. 200 (1933), 15 U. S. C. § 709(c) (1934). When this section was declared unconstitutional as an unlawful delegation of legislative power in Panama Refining Co. v. Ryan, 293 U. S. 388 (1935), Congress replaced it at once with the Connally "Hot Oil" Act which set up an administrative machinery for preventing interstate transportation of oil or gasoline produced in excess of state quotas, 49 STAT. 30 (1935), 15 U. S. C. § 715 (Supp. 1939). The Act's operation was continued in 1937 and again in 1939. 50 STAT. 257 (1937), 53 STAT. 927 (1939). Its enforcement has been aided by a compact among the oil states, 49 STAT. 939 (1935); 6 TNEC, VERBATIM RECORD OF PROCEEDINGS (1939) 67-68, 188-89; Ely, The Conservation of Oil (1938) 51 HARV. L. REV. 1209, 1215.
38. The Petroleum Code, Art. III, § 1 (limitation on imports); id. § 2 (withdrawals of crude subjected to approval of Planning and Coordination Committee); id. § 6 (price-fixing). These provisions, except for the extension of the price-fixing mechanism to gasoline prices, were adopted from a code submitted by the major-dominated American Petroleum Institute. WATKINS, OIL: STABILIZATION OR CONSERVATION? (1937) 60-61, 64. The Planning and Coordination Committee, which represented the industry in the code's administration, was regarded by NRA's Review Board as an instrument of the major companies. 2 REP. NAT. RECOVERY REV. BOARD (1934) 50, 52.
naturally failed to rise in proportion, the refiner was squeezed between high crude costs and low returns. The buying programs were sincerely addressed toward helping the independent refiner out of the plight in which inept efforts at market control had placed him. By continuing, however, to base contract and posted prices upon the spot market price, although that price was now artificially propped rather than competitive, the majors were able to capitalize upon their good deed by an increase in gasoline prices throughout the entire area.

Since the buying programs were in aid of a Government sponsored project of "bailing out the independent refiner" and since defendants unquestionably were lulled by the knowledge and consent of petroleum administration officials into disregard of the Recovery Act's requirement of written authorization for exemption from the anti-trust laws, their contention that Government approval of their activities should have been permitted to weigh in their favor seems at first glance convincing. However, it seems undesirable from a long range point of view to permit public officers, particularly minor officials, to bind the Government to a certain course of conduct and to prevent it from effectuating changes in policy which public interest may require. Permitting officials to work an estoppel upon the Government would allow an outgoing administration effectively to sabotage the work of its successors or let a conciliatory Attorney General grant immunities to business which might seriously embarrass later anti-trust enforcement.

The economic and legal defenses advanced by the majors and accepted by the circuit court are noteworthy for their inapplicability to the realities of the gasoline market. The court recites the tiny quantity of gasoline involved as proof that competition was not impaired—an approach which wholly fails to give effect to the market practices which made the area's prices as dependent upon these few tank cars of gasoline as if the buying programs had encompassed 99% of the oil states' production. Equally unreal is the claim that elimination of part of the spot market restored competition to normal—an argument premised upon an original and peculiarly static view of competitive price as a fixed point on a scale. If supply rises above this level it becomes "surplus" or a "competitive abuse." This view ignores the dependence of supply upon price in failing to realize that the gasoline in question was "surplus" only in that it could not be sold at the price deemed proper. That the plan was voluntary rather than compulsory seems quite immaterial in view of the small amount of "surplus" necessary to be absorbed in order to gain the profits derivable from the buying programs.

40. The buying programs operated by the major companies followed upon a series of unsuccessful Government attempts at raising refinery prices. Record on appeal, pp. 952-954, 1001-1007, 1048-1051, United States v. Socony Vacuum Oil Co., 105 F. (2d) 899 (C. C. A. 7th, 1939).


42. See Katz, The Consent Decree in Antitrust Administration (1940) 53 HAW. L. Rev. 415, 419-423.


44. See Eastern States Lumber Ass'n v. United States, 234 U. S. 600, 603 (1914).
Had a few of the smaller majors refused to participate, the burden of handling a few additional cars of gasoline would scarcely have weighed very heavily upon the remaining companies. The attempt to distinguish Trenton Potteries as forbidding price-fixing but permitting price-raising seems purely logomachical, particularly in view of the fact that any price activity undertaken by a group as potent as the majors will necessarily “fix” prices. Nor does the claim that defendants’ conduct fall within the range of activities permitted by Appalachian Coals appear valid. The coal combination was always subject to effective competition and was specifically found to be unable to control prices. Indeed, the Supreme Court reserved power to revoke its blessing if the combination should in practice be revealed as monopolistic.

The companies participating in the instant programs, on the other hand, supplied 85% of the area’s gasoline, possessed complete power to control, and actually did control all gasoline prices in the area.

As a conspiracy successfully directed at setting an artificial and non-competitive price, the buying programs thus seem to fall directly within the Sherman Act. However, it is scarcely to be expected that a reinstatement of the verdict in the Socony Vacuum case will, standing alone, be a panacea for the ills of oil. The piddling fines imposed are certainly small deterrent to further monopolistic exploits. Even if to the instant case are added the other current attacks upon oil restraints — the companion suit directed against uniform jobber contracts, an action to break up the Ethyl monopoly, and an attack upon the marketing practices of west coast major companies — the effectiveness of anti-trust action against the large oil companies must necessarily be very limited. Where a score of companies thoroughly dominate a large market, each company may affect the market to a considerable extent, with the result that the market will follow the price policies of the largest company. The effects of price leadership or mutual imitation of trade practices

45. See discussion in (1939) 39 Col. L. Rev. 1441, 1444.
46. See Appalachian Coals, Inc. v. United States, 288 U. S. 344, 373, 378 (1933).
49. The 12 corporate and 5 individual defendants who remained of the original 73 defendants were fined a total of $65,000. See Comment (1939) 49 Yale L. J. 284, 290; (1940) 49 Yale L. J. 733. The case appears to have had small effect upon marketing practices in the Standard of Indiana territory. Hearings before Subcommittee No. 3, Judiciary Committee, on H. R. 2318, 76th Cong., 1st Sess. (1939) 25.
50. United States v. Socony Vacuum Oil Co., The Federal Antitrust Laws (1938) 265 (13 major companies and 11 individuals pleaded nolo to charge of maintaining uniform jobber contracts and policies in regard to jobbers; fines and costs totalled $385,000); United States v. Ethyl Gasoline Corp., 27 F. Supp. 959 (S. D. N. Y. 1939), 48 Yale L. J. 1089 (Ethyl Corp. enjoined from refusing to sell to those jobbers whose “business ethics” or price policies were unsatisfactory to Ethyl’s licensee oil companies); United States v. Standard Oil Co. of Cal., N. Y. Times, Nov. 15, 1939, p. 15, col. 2 (oil companies selling approximately 85% of gasoline in Pacific Coast territory indicted on grounds of price-raising and restriction of production).
NOTES

are almost the same as those of an actual agreement between competitors,51 but there is no "contract, combination or conspiracy" to fall within the rubric of the Sherman Act. The oil cases may have as their chief effect the realization by the majors that, by acting separately but following each other's lead, they may reap the advantages of combination without danger of prosecution.

The cases, however, seem to herald a more potent legislative attack upon the major companies. Rumblings have already been heard in the form of proposals for federal control of the petroleum industry,52 for classing oil as a public utility and for vertical disintegration of the major companies.53 Application of chain store taxes to service stations has forced the major companies to make a nominal retreat from the retail field.54 A bill recently introduced in Congress would separate oil marketing from the other stages of the industry.55 A cry for pipe line divorcement has become increasingly audible.56 Inherent in the policy of disintegration are the enormous difficulties which attend the unscrambling of billion dollar eggs,57 but inasmuch as the dominance of the majors is owing to their integrated positions, a breakup along vertical lines seems the most effective route for a return to competitive conditions.

A Supreme Court decision favorable to the Government in the present case may well have importance beyond the limits of oil. In so far as the effective-

51. Price leadership is important as a fertile source of other restraints. The instant conspiracy was successful only because it operated upon a market featured by price leadership. Had retail and tank-wagon prices not adhered to the market leader's quotations, they would not have risen in unison to the raised spot market level, and the market rigging scheme would have been forced to give way before price competition.

52. See proposal of Secretary Ickes, N. Y. Times, Nov. 11, 1939, p. 9, col. 7; Hearings before a Subcommittee of the Committee on Interstate and Foreign Commerce on H. R. 414, 73d Cong., Recess (1934) 433-56.

53. 6 TNEC, VERBATIM RECORD OF PROCEEDINGS (1939) 261-64; Kemmerrer, REBIRTH OF MONOPOLY (1938) 230.


55. See Hearings before Subcommittee No. 3, Judiciary Committee, on H. R. 2318, 76th Cong., 1st Sess. (1939) 1.

56. The National Recovery Act authorized the President to institute proceedings to divest pipe line companies of their control of natural gas pipe line.

57. It is also feared that disintegration, by requiring each stage in the industry to return a profit, may raise prices to consumers. 2 N. Y. LEGISLATURE, REPORT OF JOINT COMMITTEE ON GASOLINE (Legis. Doc. No. 93, 1938) 15; Hearings before Subcommittee No. 3, Judiciary Committee, on H. R. 2318, 76th Cong., 1st Sess. (1939) 177.
ness of the conspiracy depends upon the size of the majors rather than upon
the fact of combination, the case may be an opening gun in an attack upon
the statement in the *Steel* case that “the law does not make mere size an
offense."58 In particular, it furnishes an opportunity for the court to state
that it will not brook extension of *Appalachian Coals* to nullify the anti-trust
laws whenever an industry chooses to stigmatize a market factor with an
epithet such as “competitive abuse” or to invoke the talisman of “cooper-
ation.” A clear announcement that the Supreme Court will not be hood-
winked by “pious protestations and smug preambles . . . . when men are
found busy with schemes to enrich themselves through circumventions”59
may well give pause to big business in many fields besides oil.

VALIDITY OF A LIEN CREATED BY SEGREGATION OF STOCKS
AND BONDS AS SECURITY FOR A LOAN*

In New York the status of a lender for whom stocks and bonds are segre-
gated as collateral, when the instrument is not recorded under Section 230
of the state Lien Law, has been unsettled since the case of *Sexton v. Kessler*1
in 1911. At that time an unfiled mortgage of “goods and chattels” was void
by statute as against creditors, unless there was immediate delivery by the
mortgagor and a permanent change of possession.2 But since stocks and bonds
were categorized as choses in action rather than goods and chattels,3 this
delivery requirement did not apply.4 If the contract of security were treated
as a pledge, although unfiled, it was still valid so long as delivery occurred
before a creditor attached his lien.5

In *Sexton v. Kessler*, a stockbroker-borrower, more than four months prior
to the filing of a petition in bankruptcy against him, set aside stocks and bonds
in a marked envelope as collateral for the lender. Later, during the four

59. Mr. Justice McReynolds dissenting in Maple Flooring Ass'n v. United States,
600, 608 (1914); Jones, *Historical Development of the Law of Business Competition*
(1926) 35 *Yale L. J.* 205, 226.

2. *Cumming & Gilbert's, Consolidated Laws of New York (1909) Lien Law*
§ 230.
v. New Jersey Zinc Co., 57 N. Y. 616 (1874). But the changing status of stocks is
indicated by the fact that despite classification as choses in action title passed to an
unregistered transferee in each case.
4. Niles v. Mathusa, 162 N. Y. 546, 57 N. E. 184 (1900) (mortgage of choses
in action not subject to lien law); Central Trust Co. v. West India Imp. Co., 169 N. Y.
314, 62 N. E. 387 (1901) (stocks and bonds classed as choses in action).
month period, he delivered the securities to the lender. In a suit by the broker's trustee in bankruptcy against the lender, the United States Supreme Court held that the latter was entitled to the stocks and bonds. The Court relied both on the pledge doctrine of late delivery, and on the treatment of stocks and bonds as choses in action. Fulfillment of a security contract by a delivery apparently voidable seemed contrary to the policy against secret liens accepted by New York courts. Yet since the contract involved choses in action, even New York law admitted of the result. Thereafter it was uncertain whether a loan secured by designated stocks and bonds, accompanied by a late delivery, or none at all, gave the lender title as against a creditor, a trustee or even a bona fide purchaser.

Legislative remedies have failed to remove this confusion. A clear rule for ten day late delivery in pledge would seem to be afforded by the Uniform Trust Receipts Act, but no court has yet considered it applicable. Under the Uniform Stock Transfer Act, a bona fide purchaser of mortgaged stocks

6. The doctrine of "relation back" permits what is normally a voidable surrender of possession, on the fiction that it occurred at the time of the original agreement to give security. Thompson v. Fairbanks, 196 U. S. 516 (1904); Humphrey v. Tatman, 198 U. S. 91, 95 (1904). Its application in Sexton v. Kessler, 225 U. S. 90 (1911), made a violent extension of Parshall v. Eggert, 54 N. Y. 18 (1873), on which the Supreme Court based its late delivery argument; for that case was sent back for a new trial to discover whether the clerk who gave physical possession to the lender, had authority to turn over rightful possession. The implication is that late delivery must occur and cannot be forced, so that no right to the pledged articles existed. "Relation back" was intended to "perfect" a right against third parties, but seems to have created it altogether. Sexton v. Kessler, 225 U. S. 90, 98. See Note (1937) 37 Col. L. Rev. 619, 624, n. 17. Cf. Glenn, The "Equitable Pledge," Creditors' Rights and the Chandler Act (1939) 25 Va. L. Rev. 422, 425 et seq. The New York court's hostility to imperfect contracts of security led to the requirement of promptness in recordation, by which it overthrew otherwise valid chattel mortgages. Karst v. Gane, 136 N. Y. 316, 32 N. E. 1073 (1893); Stephens v. Perrine, 143 N. Y. 476, 39 N. E. 11 (1894).

7. With neither filing nor delivery a mortgage of choses in action had been held valid against an assignee for value without notice. Central Trust Co. v. West India Imp. Co., 169 N. Y. 314, 323, 324, 62 N. E. 387, 390 (1901).


9. N. Y. Laws 1934, c. 574, Pers. Prop. Law §§ 50–58 (esp. §§ 53(1)). Bacon, A Trust Receipt Transaction: II (1936) 5 Fordham L. Rev. 240, 268. To the late delivery rule of Parshall v. Eggert, 54 N. Y. 18 (1873), this statute adds validity against attaching creditors for the ten-day period. Since it makes no exceptions, it should include pledges of stock and bonds, and to this extent would amend § 230 of the Lien Law which requires delivery on the day of the loan.

10. The court in the instant case was content to point out that, if applicable, the rule was consistent with their result. Matter of Wyser & Diner, C. C. A. 2d, Dec. 1939, note 7. Although not meant to change constructive delivery, the statute was intended to create a certain rule for late delivery. HANDBOOK, NAT'L CONF. COMMS. ON UNIFORM STATE LAWS (1933) 250.
would be protected against the secret liens of third parties, but the main preference problems remain, since creditors and the trustee in bankruptcy would still lose out to the mortgagee, despite the absence of delivery and recordation. For the protection of creditors, an amendment to the New York Lien Law required recordation or delivery of possession to validate certain types of "mortgage or pledge of, or lien upon stocks and bonds." But this Act still left a loophole through which a lender's lien on stock or bonds might escape its requirements, because in effecting the purpose to exempt contracts securing brokers' one-day loans from recordation, the language chosen included loans for a longer period only by inference. By rejecting the inference it would still be possible to create an unfiled lien upon undelivered stocks and bonds, good against an attaching creditor, to secure the ordinary loan of more than one day.

A recent decision of the Circuit Court of Appeals for the Second Circuit, however, closes this last avenue of escape. A stockbroker-borrower set aside securities in an envelope as collateral for a loan of one year, marked the envelope with the lender's name and noted the transaction in the firm books. Later the broker went bankrupt without having surrendered possession of the stock, and the trustee in bankruptcy took possession. The lender claimed the segregated securities, arguing the existence of either a valid pledge without manual delivery, a mortgage of choses in action, or a valid declaration of trust by the broker. The court, without placing the transaction in any of these categories, held it void "by whatever name," for failure to comply with Section 230 of the New York Lien Law. Under that statute "any lien upon stocks and bonds" is now void against creditors unless there is delivery of possession or recordation of the instrument. By this construction Sexton v. Kessler is no longer authority for evading Section 230 of the Lien Law.

However, the statutory requirement for a "lien upon" stocks and bonds is not, as in the chattel mortgage provisions, an immediate and continued

13. The trustee shared the fate of an attaching creditor. 30 Stat. 565 (1898), 11 U. S. C. § 75a(2) (1927). By § 70c of the Bankruptcy Act as amended in 1938, the trustee retains the rights of an attaching creditor. 52 Stat. 870-871, 11 U. S. C. § 110c (Supp. 1938). He has the further power by § 60a to void any transfer which is not so perfected prior to the petition that a bona fide purchaser may not thereafter get rights against the transferee. The principal case began before the 1938 Amendment became operative, and hence it was not applied. For the relation of § 60a to § 60e, see note 22 infra. Citations to the Bankruptcy Act hereafter will refer to the Act as amended in 1938 and will be by section number only.
change of possession. Instead, it may be satisfied by recordation or "delivery." The word "delivery," when used alone, would seem to require less than the exacting change of possession required for chattel mortgages. Liberal construction of the delivery concept might become a new mode of upholding contracts of security otherwise invalid. It suggests the possibility that the result of Sexton v. Kessler may again be reached, within the terms of the statute.

This development might well be urged if Section 60e of the amended Federal Bankruptcy Act should be construed to confer title on one who loans money to a stockholder on the security of segregated stocks and bonds. By this section preferential treatment is accorded to a "customer" class so broadly defined that it would seem to include a lender secured in this manner. Customers are "persons who have claims on account of securities received, acquired or held by the stockbroker," not merely for the purchase or sale of stocks, but also by reason of "loans of securities" to the broker, or "for safekeeping." A person for whom stock is segregated and marked as collateral for a loan of money is nowhere excluded. He might be included as a claimant "on account of securities . . . held . . . for safekeeping." Inclusion would result in a status similar to that of purchasers, vendors and lenders of stock. Such a parallel is consistent with the policy of this section, that claimants for securities shall all be grouped as creditors, for whom a new rule of priority is created.

To certain customers of a stockbroker called "cash customers," Section 60e(5) gives a "specific title" to securities which are properly segregated, if no payment is due on them. The stocks and bonds must be physically set aside or registered in the customer's name four months before bankruptcy, or while the broker is still solvent, and must remain so allocated. By this provision the lender would achieve the result of a perfect pledge without obtaining possession. This protection, comparable to that afforded a paid-up purchaser or lender of stock, and superior to that of the margin purchaser, would not be inequitable, by reason of the values each gave in exchange for the securities received. The lender's rights exceed those of general creditors who have no "claims on . . . securities." Subsequent purchasers or pledgees

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17. Section 60e(1).
18. The one reference to pledge, in paragraph (3), merely disposes of excess allotments to the lender. It applies equally well to excess segregations.
19. Mr. J. A. McLaughlin summed up § 60e in these words: "We are trying to put all these customers whose money has gone into the security account of the broker in one boat and do away with the present situation . . ." Hearings before Committee on the Judiciary on H. R. 6439, 75th Cong., 1st Sess. (1937) 127. Paragraphs (2) and (5) of § 60e refer to claimants for the customers' fund as a "single and separate class of creditors." See HANNA AND McLAUGHLIN, THE BANKRUPTCY ACT OF 1898 AS AMENDED (1939) 61.
21. Section 60e(4). In the noted case certain of the securities remained segregated until bankruptcy. Record on Appeal, pp. 7, 8.
who obtain possession are not affected, because a customer's rights by segre-
gation are extinguished by removal of the securities.22

This construction should not be avoided because of the possibility of fraud
usually urged against pledges where neither recordation nor delivery is
effect ed.23 New York courts for about seventy years prior to the 1938 Amend-
ment to the Bankruptcy Act allowed a margin purchaser to recover his full
investment from the broker's trustee in bankruptcy, although there was neither
delivery, segregation nor marking.24 Under Section 60e, since segregation
of stock loaned to the broker is sufficient safeguard against fraud, a segregation
of stock as collateral for a loan of money cannot be attacked for that reason.
It is also unlikely that rights created under the Bankruptcy Act can be attacked
because of conflict with state lien law.26

Since the status of a stockbroker's trustee in bankruptcy is at least equal
to that of the attaching creditor, recognition of a right against the trustee
in stockbrokers' bankruptcies might be persuasive in state courts that a
similar right should exist against attaching creditors.26 The requirement of
"delivery" in Section 230 of the New York Lien Law may then be recon-
sidered to determine whether segregation by the borrower is sufficient to
satisfy the statute.

Possession by the borrower when his creditor's attachment is levied does
not always invalidate a pledge. He may be holding in behalf of the lender,
as in cases where delivery in pledge occurred and the articles were returned
to the borrower in bailment.27 Bulky articles may be delivered constructively

22. Section 60e(4). Note that § 60e confers a title where segregation lasts until
bankruptcy. Manual delivery to a third party cannot then occur, and without it the
borrower is unable to effect a bona fide purchase. N. Y. Pers. Prop. Law § 162. Thus
§ 60e does not conflict with § 60a which only concerns transfers after which a bona
fide purchaser could obtain rights superior to the transferee. Segregation serves the function
of delivery in pledge.


97, 98 (1911). There need only be sufficient shares of the kind ordered. Gilchrist, supra
note 20, at 55.

25. Congress' power to make uniform laws in bankruptcy by U. S. Const. Art. III,
§ 8 is probably not limited to fixing the trustee's status. Hearings before Committee on the
of Swift v. Tyson (1938) 47 Yale L. J. 1336, 1350; Skilton v. Coddington, 185 N. Y.
80, 88, 77 N. E. 790, 791 (1906). Cf. Gilchrist, supra note 20, at 64.

26. By § 70c the trustee has the rights of an attaching creditor. The contention that
§ 60a confers on the trustee the status of a bona fide purchaser, McLaughlin, loc. cit.
supra note 6; Glenn, op. cit. supra note 6, at 447 has more recently been disputed. Glenn,
The Chandler Act and the Trustee as a Bona Fide Purchaser (1939) 25 Va. L. Rev. 885.

27. Hickok v. Cowperthwait, 210 N. Y. 137, 103 N. E. 1111 (1913); Parshall v.
Eggert, 54 N. Y. 18 (1873) (alternative holding); See McCoy v. American Express
Allester [1922] 2 Ch. 211 (both cases permitting return to debtor for sale in behalf of
lender). Conceivably, this rationale fits the instant case; but the record does not state
whether or not the lender ever had manual possession of the securities and then returned
them. Matter of Wyser & Diner, Record on Appeal pp. 12, 15. Professor Glenn makes
this explanation of the holding in Sexton v. Kessler. Glenn, supra note 6, at 448, 449.
in pledge, merely by identification and marking with the pledgee's name.\footnote{28} Delivery by a borrower to his own agent may satisfy as a delivery to the lender, if the agent agrees to hold for the lender.\footnote{29} The essence of these cases appears to be that in the absence of manual delivery to the lender, and continued possession by him, security may be given by the mere separation of the articles of pledge from the borrower's property, which he or an agent then hold in the lender's behalf. Yet no New York precedent in the pledge field has gone so far as to validate a contract of security against creditors, when the articles were convenient of manual delivery, and remained merely segregated in the debtor's possession.\footnote{30}

Related cases, however, have made the separation and marking of a fund for a particular purpose sufficient for transfer.\footnote{31} Where a deposit of money is set apart to pay dividends, either placed in a bank under the debtor's name,\footnote{32} or held by the debtor himself,\footnote{33} the fund is considered devoted to that purpose and may be claimed by designated transferees as against creditors.\footnote{34} If the fund is set aside for interest payments, and further is credited to the transferees, it follows the same rule although never out of the debtor's possession.\footnote{35} The outline of this transaction would fit the security contract of the instant case which segregates stocks and bonds, marks them as the lender's and notes the interest created thereby on the company's books.\footnote{36}


\footnote{31} See People v. City Bank of Rochester, 96 N. Y. 32, 36 (1884).


\footnote{34} If segregation is treated as a "delivery" in pledge the security is valid against any creditor. \textit{Restatement, Security} (Tent. Draft No. 2, 1938) §35(b), (c). In chattel mortgage cases, the difference between simple and attaching creditor has been one of procedure rather than substantive right. Southard v. Benner, 72 N. Y. 424 (1873); Skilton v. Coddington, 185 N. Y. 50, 87, 77 N. E. 750, 791 (1905). For pledge the Uniform Trust Receipts Act perpetuates the distinction for cases where no delivery has occurred. Conditional sales have been accorded a similar distinction under N. Y. Prs. Prop. Law §65. \textit{In re Pellegrini}, 248 App. Div. 526, 290 N. Y. Supp. 774 (2d Dep't 1936).

\footnote{35} Van Dyck v. McQuade, 86 N. Y. 38, 52 (1881). The court relieves a bank: trustee of the duty to contribute, partly because an interest declaration is a complete transfer as soon as it is credited to the depositors; later acquiescence is inoperative. The court indicates at page 52 that this transfer is good against creditors.

\footnote{36} The fact that substitution occurred should not defeat the contract of security. Markham v. Jaudon, 41 N. Y. 235 (1869); Brackett v. Harvey, 91 N. Y. 214 (1833);
The result would not affect the superior title of subsequent purchasers and pledgees for value.\textsuperscript{37} As to simple creditors, the delivery function is served in that the borrower's books reveal the change in interest to third parties who make inquiry. The device might be urged because of the convenience to both parties in keeping the pledged stocks available for sale.\textsuperscript{38}

Thus although the court in the instant case seems sound in its holding that the creation as against creditors of "any lien upon stocks and bonds" is to be determined under Section 230 of the Lien Law, its result may well be reversed under Section 60e of the Bankruptcy Act, or by extensions of the "delivery" concept of the New York Lien Law.\textsuperscript{39}


\textsuperscript{38} The lender in the noted case departed for the Orient immediately after the contract of security was made, so that bailment in touch with the market was necessary. Where the lender is not a financial expert, bailment of his stocks would be similarly practical. See Glenn, \textit{supra} note 6, at 449.

\textsuperscript{39} The court suggested a construction of § 230 of the Lien Law which precludes this development; "delivery" being construed to mean the same immediate and permanent change of possession required earlier in the statute for chattel mortgages. Though that course involves a new strictness in the treatment of stock and bond contracts, it would be in harmony with the policy against "secret liens." Irving Trust Co. v. Lindner, 264 N. Y. 165, 175, 190 N. E. 332, 335 (1934); Clark v. Flynn, 120 Misc. 474, 480, 199 N. Y. Supp. 583, 587 (Sup. Ct. 1923); Comment (1925) 34 \textit{Yale L. J.} 891.