NOTES

IMMUNITY FROM SUIT OF FOREIGN SOVEREIGN
INSTITUTIONALITIES AND OBLIGATIONS*

In an era when a foreign sovereign's immunity from municipal jurisdiction amounted simply to protection of diplomatic representatives and naval vessels, liberal dispensation of the privilege rarely frustrated the rights and remedies of individuals. But the multiplication of government instrumentalities since the World War, together with the acceleration of international intercourse, has brought increasing numbers of foreign government ships and corporations into municipal jurisdictions, inducing many courts to carve exceptions into the rule of unlimited sovereign immunity. Departure from the tradition of full immunity, which automatically obviated diplomatic repercussions, has in turn produced the delicate problem of gearing judicial decisions to the more significant manifestations of national foreign policy.

Immunity was freely granted by Anglo-American courts long after the Continental tribunals moved to confine its bounds. Traditional justification for the broad privilege was a desire to preserve comity and international goodwill by paying tribute to the dignity and independence of foreign sovereigns. Courts have also been impressed by the theoretical impossibility of executing judgments against sovereigns or their subsidiaries except through diplo-

6. See The Schooner Exchange v. McFaddon, 7 Cranch. 116 (U. S. 1812); The Parlement Belge, 5 F. D. 197 (1880).
matic devices, the ultimate of which is war. And a desire for reciprocal privileges and a related fear of reprisals are often strong motivations.

But the competitive advantage over private domestic ships and corporations afforded to foreign sovereign subsidiaries under the cloak of immunity seems unjustifiable. Difficulty of execution is absent in the usual case beginning with the attachment of funds or the libelling of a ship. Moreover, there is no record of any serious diplomatic reprisal resulting from an exercise of jurisdiction. And the suggestion that a casus belli might accrue seems unrealistic. Finally, the makeshift diplomatic remedy held out to those injured by foreign sovereign instrumentalities or owed money by them is even clumsier and less certain than the legislative redress available to those who sue domestic sovereigns.

It is therefore only natural that some American courts have recently attacked immunity on both the substantive and procedural levels. As a matter of substantive law they have employed a distinction between private-commercial and public functions of foreign sovereigns' ships and instrumentalities—jure gestionis as distinguished from jure imperii. To implement the distinction definitional criteria have been evolved. The immunity of a foreign ship has turned upon its government ownership and possession as well as its public use. Foreign corporate instrumentalities have been examined to determine whether or not their functions could be performed by private entities. Courts have also looked to stock ownership, legal title, the ultimate beneficiary of profits, and juristic status in its own municipal courts as indicia of the jure gestionis of instrumentalities.


11. "Embarrassment" seems to be the essence of the diplomatic difficulty to be anticipated in the ordinary suit. JAFFE, JUDICIAL ASPECTS OF INTERNATIONAL LAW (1933) 51. But see p. 1092 infra.


15. See Brinton, supra note 5, at 60.

The dichotomy may be an adequate device to restrict excessive privileges of immunity for ships and corporations. But these definitions do not encompass those important situations in which a sovereign's funds on deposit in the jurisdiction, already appropriated and designated for the payment of specified bonds or obligations, are attached in order to establish quasi in rem jurisdiction over the public obligations or bonds in question. Moreover, it has often been impossible for a stakeholder to interplead to establish ownership of a fund where a sovereign is one claimant unless the sovereign invokes the jurisdiction as plaintiff and is met with a counter-claim or makes a general appearance in defense. Even if a sovereign, in order to gain the confidence of its creditors, expressly contracted to submit disputes to American courts, or to arbitrate here, no jurisdiction could be established in a specific action without consent. Only where the sovereign is cestui que trust of real property, have American courts exercised jurisdiction over title claims without regard to the sovereign's beneficial interest.

European courts, recognizing the inequity and uselessness, as a matter of diplomacy, of automatically vitiating contracts to submit to jurisdiction and of frustrating litigants' remedies simply because a sovereign might be a party at interest, have transcended the doctrinal confines of the public-private concept. Contracts consenting to suit or arbitration have been enforced. Furthermore, a sovereign's participation in commercial enterprise has become merely one kind of implied waiver of immunity. A sovereign agreeing to make payments on its obligations or making deposits requisite to such pay-


22. See cases collected and translated in Draft Convention on the Competence of Courts in Regard to Foreign States, supra note 3, at 553-555, 557, 558.

ment is also deemed to have waived immunity and to have consented to quasi-in-rem jurisdiction. The refusal of American courts to implement its existing doctrine with the approach of these European decisions leaves a significant and inexpedient hiatus in the efforts to restrict unnecessary immunity.

The timidity of American courts in regard to substantive restrictions has not been reflected, however, in the strict procedural limitations which some courts have imposed upon sovereigns claiming immunity under the public-private doctrine. Where a suit involves a sovereign directly as a named and indispensable party defendant, the courts will take judicial notice of its claim upon an informal suggestion from the sovereign's diplomatic representative or from an amicus curiae. But if there is "apparent jurisdiction"—in rem where a ship is libelled, in personam against a government corporation or non-diplomatic agent, or quasi in rem over other attachable property—the sovereign must now maintain the burden of proving judicially its instrumentality's right to immunity. Moreover, the procedure for presenting this proof has been specially prescribed. Should the sovereign seek to present its claim and proof directly, only a special appearance by its ranking diplomatic representative will satisfy the ritual. If the sovereign deems such a special appearance beneath its dignity, the so-called "suggestion" procedure whereby the sovereign may lodge a claim with the State Department to be relayed to the court through the Department of Justice and its district attorney in the form of a "suggestion" of immunity is usually available. Only one possible escape remains: the Supreme Court has said that where the State Department recognizes and allows the claim, it is the duty of a court to abdicate its jurisdiction automatically without requiring the proof which might ordinarily be demanded.

Recent New York cases, however, threaten to reduce even this last redoubt of automatic immunity without proof. The difficulty in determining what claims are "recognized and allowed" stems from the State Department custom of addressing the courts in the ambiguous idiom which is the language of diplomacy. The Department has persisted in an almost uniform "suggestion," irrespective of political circumstances, which relates the claim

25. See Feller, supra note 4, at 83; Déak, supra note 4, at 456 et seq.
28. See Ex parte Muir, 254 U. S. 522, 533 (1921); Feller, supra note 4.
31. E.g., "In reply to your inquiry you are informed that the State Department would not have had the representations of the Brazilian Ambassador presented to the Court had it felt that they were without merit." Unreported communication from State Department to counsel for defendant in Sullivan v. State of Sao Paulo. See also letters in Sullivan v. State of Sao Paulo, 36 F. Supp. 503, 504, 505 (E. D. N. Y. 1941).
received but conspicuously omits the apt words and contains a disclaimer of any desire to encroach upon or influence the jurisdiction of the court.\footnote{32}

As a result, there have been two mutually exclusive and incomplete interpretations of this ambiguous \textit{pro forma} suggestion. Construing the language at face value, the New York courts have conceived the usual suggestion as no more than an alternative to a special appearance by which the sovereign indirectly lays his claim before the court subject to its independent judgment.\footnote{33} Under this view the State Department becomes a mere “conduit,”\footnote{34} Actual transmission of the claim is not deemed a certification.

Insofar as this interpretation whittles away at automatic immunity, it is a commendable extension of the general movement to limit immunity. But other courts, apparently recognizing the hazards of judgments which encourage diplomatic complications, have decreed immunity automatically upon receipt of vague suggestions bearing allegations which probably would not support a plea upon special appearance.\footnote{35} Actually, however, the State Department considers its suggestions more than perfunctory courtesies—a fact demonstrated by refusals to comply with requests that it suggest where it disapproves of granting immunity\footnote{36} and by the custom of transmitting suggestions in support of, as well as in lieu of, special appearances.\footnote{37}

This unfortunate split of decisions, threatening vital foreign relations in some jurisdictions and breeding unnecessary immunities in others, could readily be resolved by the State Department’s articulation of its position through the apt words “recognized and allowed.” Justification for continued ambiguity is unconvincing. It has been argued that the establishment of conclusive “communications” between the Department and the courts would deprive the Department of its traditional apology to foreign

\footnote{34. \textit{E.g.}, Ervin v. Quintanilla, 99 F. (2d) 935 (C. C. A. 5th, 1938), \textit{cert. denied}, 306 U. S. 635 (1939). In \textit{Sullivan v. State of Sao Paulo}, the court, pursuant to the State Department’s suggestion, refused to attach funds in the hands of Sao Paulo’s fiscal agent designated for service of the very bonds the plaintiff held. The court held, not as a “matter of law” but because of “comity,” that Sao Paulo was entitled to immunity even though it lacked “external” sovereignty. Immunity has generally been accorded American states and even territories, irrespective of external sovereignty. Monaco v. Mississippi, 292 U. S. 313 (1934); Kawananakoa v. Polybiank, 205 U. S. 349, 353 (1906). But the great weight of foreign decisions and the one American case on the question have not granted immunity to political subdivisions of foreign states. See Leubrie v. State of Sao Paulo, 97 N. Y. L. J. 2160 (April 30, 1937). The European cases are collected in \textit{Draft Convention on the Competence of Courts in Regard to Foreign States}, \textit{supra} note 3, at 483-488.}
\footnote{35. \textit{E.g.}, The Pesaro, 277 Fed. 473, 479 (S. D. N. Y. 1921); Molina v. Comision Reguladora del Meriado de Hequeuen, 91 N. J. L. 382, 103 Atl. 397 (1918); \textit{cf.} The Maipo, 252 Fed. 627, 628 (S. D. N. Y. 1918); The Navemar, 303 U. S. 68 (1938).}
nations injured by the courts or the states—that the Department has no control under the Federal system. But precise and mandatory language could be reserved for the special situation where court decisions might impair definite diplomatic objectives and policies. In all other cases the Department's suggestion would permit determination of a sovereign's claim under the "conduit theory."

The notion that "dictation" by the Department would violate the principle of separation of powers reflects a misconception of the intrinsic nature of an affirmative as distinguished from a mere "conduit" suggestion. The affirmative suggestion is not on its face an attempt by the State Department to substitute its own legal opinion, either of the facts or of the law, so as to encroach upon the judicial function of the courts. The affirmative suggestion should be considered, instead, as a finding of diplomatic necessity by the State Department in the exercise of its responsibility for foreign affairs which should govern the courts whenever the executive deems conformity necessary to the administration of foreign relations. Far from violating the concept of separation of powers, such cooperation would be consistent with the traditional abstinence of the courts from political questions and with the policy of the incumbent Supreme Court to give full credence to the Congress and the Executive in their respective spheres of responsibility.

The view that decisions touching delicate foreign relations should conform to the policies of the Executive has long been recognized in England and on the Continent as a necessary corollary to strict construction of sovereign immunity, presumably because of the greater significance of diplomatic relations to those "unisolated" countries. The changing position of foreign affairs on the American stage seems to justify a brake upon the widening limitations of sovereign immunity in the form of a clear conceptual device with which to draw special exceptions upon demand of the State Department.

37. See The Florence H., 248 Fed. 1012, 1017 (S. D. N. Y. 1918). See also Jaffe, op. cit. supra note 11, at 40; Déák, supra note 4, at 461.
38. See Jaffe, op. cit. supra note 11, at 38.
40. In the Sullivan case the court, relying upon informal correspondence in which the State Department amplified its bare suggestion, found that "finality" should be accorded the executive's "recognition" of claimant's "facts." But see The Maipo, 252 Fed. 627 (S. D. N. Y. 1918).
42. E.g., Z. & F. Assets Realization Corp. v. Hull, 61 S. Ct. 351 (U. S. 1941). Certification of a claim by the Secretary of State to the Secretary of Treasury under War Claims Act was held not a mere "notarial" or ministerial act, but rather conclusive upon the courts. Mr. Justice Black, concurring, at 358, emphasizes the exclusive responsibility of the Executive in the "momentous question of public policies affecting this nation's relations with the other countries of the world."
STATE LIMITATIONS ON FEDERAL EQUITY JURISDICTION*

Although federal courts have frequently asserted that state statutes and decisions may neither enlarge nor limit federal equity jurisdiction, there has been a marked difference between their doctrinal pronouncements and the results they have reached. The decisions often reveal a policy of enlarging federal equity jurisdiction by enforcing state-created substantive rights, as well as a refusal to enforce similarly created remedies. Federal equity jurisdiction has been limited, moreover, in order to avoid conflict between courts over a single res and to further intergovernmental comity. The relationship of both these principles of federal equity jurisdiction is illustrated in *Kelleam v. Maryland Casualty Company,* recently decided by the Supreme Court.

Kelleam, with the Maryland Casualty Company as surety on his bond, had acted as administrator in an Oklahoma probate proceeding. As a result of that action, the entire estate was distributed between Kelleam and his sister, who were the only full blood heirs, and the surety was discharged on its bond. Alleging that the decree had been fraudulently procured by the full blood heirs, the half blood heirs brought an action in the Oklahoma court to set it aside. When their complaint was dismissed on demurrer, they appealed. While this appeal was pending, the surety, noting that the full bloods had transferred part of the property received from the estate, joined both full bloods and half bloods as defendants in an action in the federal district court, basing jurisdiction on diversity of citizenship. The surety sought exoneration from its principal, Kelleam, on its bond and appointment of a receiver to conserve the remaining assets pending the outcome of the state appeal; it subsequently amended its complaint to allege fraud on the part of the full blood heirs in the probate proceeding. The half bloods, by cross petition, had alleged the same fraud, and had also asked for a receiver. The full bloods pleaded, *inter alia,* lack of federal jurisdiction pending appeal in the state court, and moved to dismiss both the bill of complaint and the cross petition. The district court overruled this motion, and determined that the

---

*Kelleam v. Maryland Casualty Co., 61 Sup. Ct. 595 (U.S. 1941).*


3. "Federal equity jurisdiction" relates to the power of the Federal courts to grant equitable relief. It is not synonymous with jurisdiction in the strict sense, i.e., the existence of the requisite amount, or diversity of citizenship. See (1923) 33 *Yale L. J.* 193, n. 2; Von Moschzisker, *Equity Jurisdiction in the Federal Courts* (1927) 75 *U. of Pa. L. Rev.* 287. The assertion that federal equity jurisdiction may not be enlarged or limited by the states has served largely as a doctrinal device to preserve a national equity uniform in all the states.


7. See note 18 *infra.*

8. 61 Sup. Ct. 595 (U. S. 1941).
probate decree was obtained by fraud and that there had been fraudulent transfers by the full blood heirs. The court exonerated the surety on its bond, appointed a receiver to conserve the remaining assets, and ordered the full blood heirs to account. This decree was affirmed by the Circuit Court of Appeals for the Tenth Circuit.9

Holding the exercise of equity jurisdiction in these circumstances to be inappropriate, the Supreme Court reversed the lower courts’ decisions. Inasmuch as the claim of the surety was wholly contingent,10 the Court concluded that no right to primary relief had been asserted to which the receivership was an appropriate ancillary measure.11 Moreover, even if the bill of complaint had been sustained,12 the district court could not appropriately determine the issue of fraud in the probate proceeding because of the pending state action.

Federal district courts, having no original probate jurisdiction, have refrained from interfering with the administrator’s possession of the estate or with the actual disposition of the estate in the probate court.13 But actions to set aside probate decrees on grounds of fraud have in the past been entertained by federal courts in inter partes actions,14 even where jurisdiction was expressly conferred by statute upon a particular state court.15 The granting of relief in such situations was justified on the grounds that federal equity

9. 112 F. (2d) 940 (C. C. A. 10th, 1940).
10. The Court termed the action one in equity for exoneration. It could likewise have considered it an action for a declaratory judgment and determined the rights of the surety even though contingent. See Maryland Casualty Co. v. Pacific Oil & Coal Co., 61 Sup. Ct. 510 (U. S. 1941).
11. It is often asserted in federal equity practice that a receivership does not constitute an end in itself but may be used only as a protective measure where other relief is sought. Usually some final disposition of the property must be contemplated before a receiver will be appointed. SIMKINS, FEDERAL PRACTICE (3d ed. 1938) 568-9. However, the principle that a receivership may not serve as an end in itself had its development particularly in the administration of debtors’ estates. Utilization of the receivership as a device for delaying creditors called for some restrictive measures. Where these considerations are not present, as in the principal case, application of the doctrine may not be appropriate.
12. Since the surety’s bill of complaint should have been dismissed, the court had no jurisdiction to determine the merits of the controversy between the full blood and half blood heirs raised by the cross petition. No diversity of citizenship existed between the heirs. However, if the surety’s bill of complaint had been sustained, the court could have determined the issues raised by the cross petition if no state proceeding had been pending. The diversity of citizenship between the surety and the heirs would have supported the whole action. Ames Realty Co. v. Big Indian Mining Co., 146 Fed. 166 (C. C. D. Mont. 1906). See 1 Moore, FEDERAL PRACTICE (1938) 726-7.
jurisdiction may not be limited by state statutes and that the equitable decree operated only against the parties, not against the state court or against the res.\textsuperscript{16} Where a state proceeding was pending, adjudication of the fraud issue in the federal courts constituted a successful bar in the state court, preventing it from determining an issue with which it might be more familiar. The relinquishment of jurisdiction by federal courts in such situations thus seems highly advisable. The instant decision is in harmony with the well-defined tendency of the present Court to preserve "the rightful independence of state governments" where comity so demands.\textsuperscript{17} The Court has often wisely insisted upon this principle where local matters are involved.\textsuperscript{18} Application of the comity rule to the situation involved in the principal case seems equally salutary, for the administration of estates in probate is closely controlled by state statutes correlated to the mechanism of state courts. Extension of the rule would seem desirable even where the state proceeding was initiated after the federal action, or where the state statute has expressly conferred jurisdiction upon a particular state court. While technically a limitation on federal equity jurisdiction, the rule of comity may well be invoked to permit independent state control over such actions.

Although the decision could have been rested solely on the comity ground, the court seems to have relied more heavily upon a different basis. Its conclusion was premised on the fact that the surety had no present right in the federal courts to exoneration on its bond.\textsuperscript{19} Hence the receivership was termed an end in itself for the protection of the surety's contingent liability and was not ancillary to some form of primary relief.\textsuperscript{20} In reaching this

\begin{footnotes}
\item[18] In Pennsylvania v. Williams, 294 U. S. 176 (1935), equity jurisdiction based on diversity of citizenship had been assumed by a federal district court and receivers appointed in liquidating a state building and loan association. The Supreme Court directed that federal jurisdiction be surrendered, on comity grounds, after intervention by a state administrative officer charged by a detailed state statute with the winding up of such institutions. Cf. Penn General Casualty Co. v. Pennsylvania, 294 U. S. 189 (1935); Gordon v. Washington, 295 U. S. 30 (1935); General Baking Co. v. Harr, 85 F. (2d) 932 (C. C. A. 3d, 1936). Equity jurisdiction apparently need not be relinquished by the federal courts, however, if the remedy in the state is not deemed adequate or if delay or mismanagement appears in state administration. Intermountain Bldg. & Loan Ass'n v. Gallegos, 78 F. (2d) 972 (C. C. A. 9th, 1935). The Court has also indicated an intention to refrain from entertaining actions dealing with issues relating to the creation of corporations. Rogers v. Guaranty Trust Co., 288 U. S. 123 (1933). A policy of non-intervention has been adopted in federal question cases involving the enforcement of state statutes. Massachusetts State Grange v. Benton, 272 U. S. 525 (1926); Fenner v. Boykin, 271 U. S. 240 (1926); cf. Matthews v. Rodgers, 284 U. S. 521 (1932).
\item[19] In determining whether the surety had a right of action, the court adopted the old equity practice permitting the surety to sue for exoneration only after the debt had become due. 4 Pomeroy, Equity Jurisprudence (4th ed. 1919) § 1417.
\item[20] See note 11 \textit{supra}. 
\end{footnotes}
result, the Court refused to enforce an Oklahoma statute permitting a surety to bring an action for indemnity against the principal debtor before the debt is actually due. Nor would it give effect to the state statute authorizing the appointment of receivers in situations similar to that in the instant case.

The reason given by the Court for its refusal to enforce these two Oklahoma statutes was that they were considered remedial and could not enlarge federal equity jurisdiction.

The confusing doctrine that state statutes creating remedies, as distinct from those establishing substantive rights, may not enlarge the equity jurisdiction of federal courts was restated and affirmed in *Puscy & Jones Co. v. Hanssen.* The Delaware statute there involved provided that a contract creditor might bring a bill for a receivership before reducing his claim to judgment. The Supreme Court refused to follow the statute on two grounds. It held that the authorization of a receivership created only a remedy affecting equitable procedure, and was unrelated to any substantive right. It also determined that the creditor had to exhaust his remedy on the law side of the federal courts by reducing his claim to judgment before the equitable claim could arise; otherwise, the objecting debtor would be deprived of its right to a trial by jury.

In general, state statutes providing for relief in equity where an adequate remedy accomplishing the same result existed on the law side of the federal courts were termed remedial and not enforced in federal equity courts. But the action, insofar as it was based upon the legal claim, could be transferred to the law side and enforced there. The Federal Rules of Civil Pro-

21. Okla. Stat. Ann. (1938) tit. 12, § 1108 provides: "A surety may maintain an action against his principal, to obtain indemnity against the debt or liability for which he is bound, before it is due, whenever any of the grounds exist, upon which . . . an order may be made for arrest and bail and for an attachment." Okla. Stat. Ann. (1938) tit. 12, § 1107 apparently restates the common law right of the surety to exonerate, after the debt has matured, by an action to compel the principal debtor to pay.

22. Okla. Stat. Ann. (1938) tit. 12, § 1551 provides, in part, that a receiver may be appointed for the benefit of any party "... whose right to or interest in the property or fund, or the proceeds thereof, is probable, and where it is shown that the property or fund is in danger of being lost, removed or materially injured."

23. 261 U.S. 491 (1923). The case has been criticized in (1923) 33 Yale L. J. 193; (1923) 23 Col. L. Rev. 589. See also (1936) 49 Harv. L. Rev. 950.


26. Denison v. Keck, 13 F. (2d) 384 (C. C. A. 8th, 1926); Adams v. Jones, 11 F. (2d) 759 (C. C. A. 5th, 1926). This practice was introduced by the 1912 Equity Rules 22 and 23. Initially actions were dismissed without prejudice to a suit at law.
The Yale Law Journal

procedure have, however, obviated this aspect of the Pusey & Jones case by abolishing procedural distinctions between law and equity.\footnote{27} Hence the chief distinction between an equitable and legal action under the Rules lies in determining whether the party is entitled to a jury trial as of right.\footnote{28} But the other aspect of the Pusey & Jones case—that the statute authorizing the appointment of a receiver affected only equitable procedure instead of creating a substantive right—remains important despite the Federal Rules.\footnote{29} Even under the Rules federal courts will refuse to enforce procedural remedies arising from state statutes, although they will enforce state-created substantive rights.

In this aspect the distinction between substance and procedure, although confusing, is flexible and depends upon the particular situation involved.\footnote{30} In the Kelleam case, for example, there is substantial harmony between the results following from the comity argument and from the analysis in terms of the established substantive-remedial dichotomy. Since the comity principle would seem a better basis upon which to justify the decision, the Court's assertion that the statute creating a right of action in the surety before the debt was actually due was remedial can be viewed as merely re-enforcement for its decision. If a surety sought exoneration in a federal court today under the statute in a situation where the action did not interfere with a pending state proceeding relating to matters better left to state determination, the statute should be enforced as substantive. At common law the surety could maintain an action against his principal debtor only after the surety had paid part of the debt to the creditors.\footnote{31} Equity early adopted the practice of permitting the surety to bring a bill for exoneration, after the debt had matured, compelling the principal debtor to pay.\footnote{32} The Oklahoma statute involved in the principal case changed the common law rule by permitting an action to afford the surety protection even though the debt had not yet become due.\footnote{33} Consequently, it would seem to have created a substantial right

\footnote{27. The principal case arose prior to the effective date of the new Federal Rules for Civil Procedure.}

\footnote{28. If the factual situation involved in the Pusey & Jones case arose today, complete relief could be afforded in a federal civil action. The objecting debtor could obtain a trial by jury on the validity of the claim while the creditor would be afforded relief equitable in nature.}

\footnote{29. See 1 Moore, Federal Practice (1938) 210.}

\footnote{30. See Cook, "Substance" and "Procedure" in the Conflict of Laws (1933) 42 Yale L. J. 333.}

\footnote{31. See Arant, Suretyship (1931) 318-19; 4 Pomeroy, Equity Jurisprudence (4th ed. 1919) § 1417.}

\footnote{32. Ranellaugh v. Hayes, 1 Vern. 189, 23 Eng. Rep. 405 (1683); Norton v. Reid & Sutton, 11 S. C. 593 (1867). This equitable right was developed as a protective measure to enable the surety to remove the cloud which hung over him by virtue of the debt. It prevented an unnecessary withdrawal of capital before the surety could maintain his action against the principal debtor.}

\footnote{33. See note 21 supra. Under this statute the surety was afforded greater protection through an action to indemnify himself against the principal debtor even before the debt was due. Thus he could obtain relief if the principal debtor attempted fraudulent evasion of the debt through transfer or dissipation of the property.}
in the surety which would be enforceable in the federal courts in the absence of the compulsion of the comity rule.

If the right of action created by the statute were thus enforced as substantive in the federal courts, the appointment of a receiver would be considered an appropriate ancillary measure. A conservation receivership would seem necessary where the surety could show fraudulent transfers, as in the principal case, or threatened dissipation of the property. Moreover, whether or not the receivership is considered an appropriate ancillary remedy raises the further problem of the effect of *Eric R. R. v. Tompkins.* The opinion in the instant case contains no discussion of the *Tompkins* case and also overlooks the state cases which construe the Oklahoma statute authorizing the appointment of receivers in situations analogous to that presented in the principal case. But application of the *Tompkins* case to equitable matters has been established in certain instances. Federal courts apparently will determine independently what is substantive and what procedural under the *Tompkins* case, but have indicated a broad policy of conforming to state laws in shaping relief. The implication in the *Kellem* case, however, is that the *Tompkins* rule will not be given such expansive effect in all situations. Under this holding, the determination in the *Pusey & Jones* case that statutes authorizing the appointment of receivers merely create remedies affecting equitable procedure seemingly will control in the federal courts. The enforcement of such statutes, in view of the *Tompkins* case, would seem more desirable. Such enforcement would not conflict with the Federal Rules. Under Rule 64, state law is made controlling in granting provisional remedies in actions at law. Rule 66, providing that the administration of equity receiverships shall be in accordance with the former practice in the federal courts, does not specifically mention appointment of receivers. Consequently, substantial conformity with state law in appointing receivers, analogous to Rule 64, appears a desirable method of solving the substantive-remedial dilemma.

34. See Glades County v. Detroit Fidelity & Surety Co., 57 F. (2d) 449, 452 (C. C. A. 5th, 1932).
35. 304 U. S. 64 (1938).
36. See note 22 supra.
38. See, e.g., Cities Service Oil Co. v. Dunlap, 308 U. S. 208 (1939); Sampson v. Channell, 110 F. (2d) 754 (C. C. A. 1st, 1940).
39. Even though the construction of the particular state statute involved in the principal case be doubtful, yet the tenor of the Court's opinion indicated that it was termed "remedial" as a result of federal determination. It was not so termed because state courts had given it that construction. The receivership statute involved in the *Pusey & Jones* case had been construed as substantive by the Delaware Chancery Court. See note 24 supra.
AVAILABILITY OF CHAPTER XI OF THE CHANDLER ACT
FOR AVOIDING LIABILITY UNDER A STATE STATUTE*

Chapter XI of the Chandler Act1 provides embarrassed debtors with an expeditious method for obtaining judicial sanction of their settlements with unsecured creditors. Although designed principally as a quick, practical, and economical means for rehabilitating small enterprises,2 the wide jurisdictional scope of the chapter and its extreme flexibility of procedure have tempted reorganizers to abuse its purpose in seeking protection against more stringent methods of financial readjustment.

The Second Circuit Court of Appeals has recently considered the availability of a Chapter XI proceeding as a means of avoiding a debtor's liability under a state statute for fraudulent practices in the sale of securities to the public.3 The debtor was the president, majority stockholder, and active manager of Reinforced Paper Bottle Corporation, which in turn owned 100 per cent of the stock of Safety Service Milk Bottle Corporation. The Attorney-General of New York, charging fraudulent misrepresentations in the sale of stock owned personally by the debtor and issued by Reinforced, brought an action in the state supreme court under the New York Martin Act4 against the debtor and the two corporations which she controlled. The Martin Act, passed for the purpose of avoiding a multiplicity of suits and providing defrauded security holders with an efficient remedy against their vendors, authorized the state court at any stage of the proceedings to appoint a receiver of “all property . . . derived by means of” the fraudulent practices prohibited by the Act.5 After a finding that the debtor and Reinforced had engaged in fraudulent misrepresentations in the sale of the debtor's stock, the court entered a judgment appointing a receiver and authorizing him to liquidate the fraudulently derived property for the benefit of intervening claimants establishing an interest in it.6

---

*In re Koch, 116 F. (2d) 243 (C. C. A. 2d, 1940).
1. Bankruptcy Act, 52 STAT. 840, 11 U.S.C., §§ 1-1103 (Supp. 1938). Further citations to the bankruptcy Act will refer only to the section number. Sections of Chapter XI are numbered from 301-399.
5. Section 353a of the Martin Act reads in part: “. . . the court at any stage of the proceedings may appoint a receiver of any and all property derived by the . . . defendants . . . by means of any such fraudulent practices, including also all property with which such property has been mingled if such property can not be identified in kind because of such commingling . . . . The judgment . . . may provide that such receiver shall take title to any or all such property . . . for the benefit of all persons intervening in the said action and establishing an interest in such property . . . .” The section further provides for the return to defendants of property in which no intervenor has established an interest.
6. The judgment itself failed to describe specifically the fraudulently derived property. The court's findings of fact, however, somewhat ambiguously stated that the proceeds from the fraudulent sales totalled approximately $1,000,000; that the debtor
At the alleged instigation of a Stockholders Protective Committee organized for the purpose of preventing liquidation of corporate assets, the debtor and Reinforced strategically filed original petitions in separate federal courts under Chapter XI on respective pleas of insolvency. The debtor's proposed "arrangement" filed with her petition and submitted to the District Court for the Southern District of New York was made expressly conditional on the confirmation of the arrangement proposed by Reinforced in the federal court in Delaware. Both plans contemplated a readjustment of the corporation's obligations to the debtor arising principally from a series of loans extended by her at various intervals during the corporation's history. As a major creditor of Reinforced, the debtor proposed in her own arrangement to file a consent in the Delaware court to the terms of the corporate arrangement providing for the cancellation or subordination of a substantial amount of her claims. She further proposed to deliver the certificates of indebtedness issued to her as a discharge of the corporation's remaining obligations to all of her own unsecured creditors "for the full amount of all claims." All of the 31 creditors listed in the debtor's schedule filed consents to her plan.

The state court receiver, after notice, appeared before the bankruptcy referee to challenge the jurisdiction of the court over property derived by the debtor from the proceeds of the fraudulent transactions and to contest the referee's proposed orders confirming the arrangement and restraining the receiver from interfering with the debtor's possession. After a hearing, the referee issued a final order of confirmation which included an injunction against any action by the receiver to enforce the state court judgment.

1. Made loans to both corporations; that the approximate amount loaned "to the said corporation" was $650,000; that both corporations had issued promissory notes to her of about $1,200,000; and that all the assets of both corporations had been derived from the fraudulent practices. Record on Appeal, pp. 97-116.

2. In petitioning for an arrangement under Chapter XI, the debtor alleged without being controverted that the Stockholders Protective Committee had the "support" of several hundred stockholders who paid in excess of $800,000 for their stock out of a total of $1,000,000 worth sold by the debtor.

3. The face amount of the debtor's claims against the corporation, including loans, unpaid salary, and monies expended on behalf of the corporation totalled approximately $900,000.

4. The debtor proposed to cancel promissory notes of the total face value of about $350,000 issued to her by the corporation, and also approximately $30,000 on an open account.

5. To effect the subordination of promissory notes with a face value of about $318,000, the debtor planned to deliver the notes in escrow to the corporation's directors for deposit with them until such time as the corporation's net earnings were sufficient for dividends on the two prior classes of stock.

6. The proposed certificates of indebtedness to be issued to the debtor under the corporate arrangement amounted to approximately $190,000 in face value whereas the debtor's unsecured creditors held claims totalling only about $17,000.

7. None of the claims of the defrauded stockholders, however, was listed in the debtor's schedule.

8. The terms of the injunction against the state court receiver restrained him or his agents from "instituting or prosecuting any proceeding or action at law or in equity..."
From an order of the federal court overruling his petition for review, the receiver filed notice of appeal. The Circuit Court of Appeals for the Second Circuit, after two hearings, affirmed the decision of the lower court.\(^{14}\)

Notwithstanding the general desirability of preserving the state's power to administer local laws free from federal interference,\(^{16}\) the National Bankruptcy Act in special cases authorizes bankruptcy courts to take over jurisdiction from courts operating under state law.\(^{16}\) Thus, Section 2(a)(21) of the Act empowers the bankruptcy court “to require receivers or trustees appointed in proceedings not under this Act, assignees for the benefit of creditors, and agents authorized to take possession of or to liquidate a person’s property” to deliver the property in their possession to the debtor, provided the assignee, agent, trustee or receiver was appointed within four against the debtor in any court for the purpose of taking possession of or interfering with any property, assets and effects owned by the debtor, or for the purpose of exerting any claim against her.” Record on Appeal, p.9. Presumably, without violating the injunction, stockholders might have asserted individual fraud claims against the debtor, the injunction having only the effect of exempting her from the operation of the statutory remedy provided by the Martin Act.

14. After the first hearing, the court denied the receiver's claim of “title” as vested by the terms of the state judgment and affirmed the bankruptcy court's jurisdiction over the debtor's fraudulently derived property on the theory that title could not pass without a specific identification of the property by the state court. On rehearing, however, the court assumed that the findings construed with the judgment sufficiently identified the property but that, since no stockholder had intervened in the state proceedings, the debtor was the “only cestui of the receiver’s trust.” In re Koch, 116 F. (2d) 243 (C. C. A. 2d, 1940). The trust theory thus adopted by the court appears, however, to regard the receiver as a mere adverse claimant without a substantial title. It seems a grossly inadequate doctrinal device for solving the larger problem of jurisdictional conflicts between state and federal courts. Clearly inconsistent with the state statute, the holding in effect makes state jurisdiction over the property dependent on the intervention of claimants in the state proceedings.

15. A possible theory for sustaining bankruptcy jurisdiction in the instant case may be found in the rule applicable in ordinary in rem actions making jurisdiction dependent on priority of possession. See Harkin v. Brundage, 276 U. S. 36 (1928). Where the courts in conflict have “concurrent” jurisdiction the concept of “constructive possession” has been successfully used to avoid the requirement of actual seizure by a court officer, thus effecting a policy of comity. See Penn General Casualty Co. v. Pennsylvania, 294 U. S. 189 (1935). The same concept, more strictly applied, is available even where the two suits are not “substantially for the same purpose.” See, as a leading case, Adams v. Mercantile Trust Co., 66 Fed. 617 (C. C. A. 5th, 1895). But where the federal court is a court of exclusive jurisdiction, as in bankruptcy or admiralty, the stated rule requires actual seizure. See Moran v. Sturges, 154 U. S. 256 (1894). Thus, since the state court receiver in the instant case had no actual possession, it is arguable that the bankruptcy court obtained a prior jurisdiction. See Shirley, Conflicting Jurisdiction in the Appointment of Receivers (1938) 16 Tex. L. Rev. 471.

16. The bankruptcy court in a Chapter XI proceeding, for example, may not only stay pending actions in personam, perhaps ultimately discharging the claim, but it may also enjoin until final decree any action against the debtor including suits to enforce liens. See §314.
months of the bankruptcy proceeding.\textsuperscript{17} The power to issue a turnover order under the provision obviously implies a power to enjoin an interference with the debtor's possession that would subsequently require a turnover order.\textsuperscript{18} If the Martin Act receiver is one of the class of "receivers" coming within the provision, it would seem immaterial that the state court judgment vested him with "title" to the debtor's property since assignees for the benefit of creditors, expressly included in the section, have a similar type of legal title.\textsuperscript{19} It is arguable, however, that the provision was designed to cover only general receiverships. The authority of a receiver appointed under the Martin Act is limited to taking possession only of property derived from fraudulent practices prohibited by the Act; and his appointment has been held not to constitute an act of bankruptcy.\textsuperscript{20} Although limited receivers may be included within the scope of Section 2(a)(21) without violence to the rule restricting acts of bankruptcy to general receiverships,\textsuperscript{21} the legislative history of the provision indicates an intent merely to codify pre-existing case law permitting the bankruptcy court to require surrenders of possession by general equity receivers.\textsuperscript{22}

A less doubtful basis for the superseding jurisdiction of the bankruptcy court in the instant case is provided by Section 67(a) of the Act invalidating all liens against the debtor's property obtained by "attachment, judgment, levy, or other legal or equitable process or proceedings" within four months of the petition under Chapter XI and at a time when the debtor was insolvent. The Martin Act proceeding satisfied all the time requirements of the Section. The validity of claims to property by state court receivers appointed more than four months before the filing of a petition has been sustained on

\textsuperscript{17} That the provision applies to Chapter XI proceedings as well as ordinary bankruptcy is necessarily implied by the terms exempting Chapters X and XII from the four months limitation. See § 2(a) (21).


\textsuperscript{19} See Shor v. McGregor, 108 F. (2d) 421 (C. C. A. 5th, 1939); see also \textsc{Collier on Bankruptcy} (14th ed. 1940) 312.

\textsuperscript{20} Elfast v. Lamb, 111 F. (2d) 434 (C. C. A. 2d, 1940). Similarly the Supreme Court, in \textit{Duparquet Huot & Monseau Co. v. Evans}, interpreted the appointment of a receiver in a foreclosure proceeding as an insufficient basis for a reorganization petition under old § 77B(i). 297 U. S. 216 (1936). The provision might be held applicable in the Delaware proceeding on the grounds that the judgment authorized the receiver to take possession of all the corporate assets. See (1936) 36 Col. L. Rev. 150; (1936) 84 U. of Pa. L. Rev. 782-4; (1936) 3 U. of Chi. L. Rev. 325-7. See also Standard Acc. Ins. Co. v. Sheftall, 53 F. (2d) 40 (C. C. A. 5th, 1931).

\textsuperscript{21} Perhaps the strongest argument for including limited receivers within the provision may be found in one of the various theories formerly used to sustain turnover orders issued to receivers appointed in suits on creditors' bills: namely, that bankruptcy nullified the appointment as a judgment, levy, or lien within the purview of old § 67. Blair v. Brailey, 221 Fed. 1 (C. C. A. 5th, 1915), \textit{cert. denied}, 238 U. S. 634 (1915); First Nat. Bank v. Guarantee Title & Trust Co., 178 Fed. 187 (C. C. A. 3d, 1910); Mauran v. Crown Carpet Lining Co., 23 R. I. 324, 50 A. 331 (1901).

\textsuperscript{22} H. R. REP. No. 1409, 75th Cong., 1st Sess. (1937) 20. See also, \textsc{Collier on Bankruptcy} (14th ed. 1940) 299-300.
the theory that their appointment operates as an "equitable attachment."\(^\text{23}\) A similar argument seems to be available to establish the invalidity of a receiver's lien acquired \textit{within} four months of a petition.\(^\text{24}\) Notwithstanding the doctrine that local law determines the effect of state court judgments,\(^\text{25}\) the use of the word "lien" is obviously not essential to create the consequent legal relations implied by the term. The qualified title of a receiver asserted for the benefit of unidentified claimants appears to fall clearly within the scope of the provision, especially since its general purpose is to avoid preferences created by legal proceedings. The theory that the bankruptcy court acquired jurisdiction of property claimed by the receiver under a void lien is simplified by a new provision of the Act overruling earlier case law\(^\text{20}\) and subjecting adverse claimants under Section 67(a) to the summary jurisdiction of the bankruptcy court.\(^\text{27}\) Since, moreover, in the instant case the federal court in Delaware might for similar reasons assume control of the corporation's assets, the possibility of invoking federal jurisdiction conceivably provided the defrauded stockholders with an opportunity of sacrificing their insubstantial shares in the liquidation of corporate assets for a more profitable rehabilitation of their interests in a going concern. The purported purpose of the Chapter XI proceeding, supported by the Stockholders Protective Committee, was to avoid, for the benefit of stockholders, a liquidation of the corporation under the Martin Act.\(^\text{28}\)

But a recognition of the bankruptcy court's statutory jurisdiction over the debtor's assets, including those claimed by the receiver, does not, of course, determine the principal issues of the propriety of the order confirming the arrangement or the validity of the injunction against enforcement of the state court judgment.\(^\text{29}\) A free exercise of discretion by the court in confirming arrangements seems generally desirable in light of the absence of specific statutory criteria for determining the fairness of the plan and the


\(^{24}\) Liens within the scope of § 67(a) are void irrespective of whether the obligations on which they were obtained are provable or dischargeable. \textit{Wagner v. Mt. Carmel Iron Works}, 270 Fed. 80 (C. C. A. 3d, 1921); \textit{In re Green}, 179 Fed. 870 (W. D. Pa., 1910).


\(^{26}\) Formerly, receivers asserting a lien and denying the existence of facts sufficient for invalidation under § 67 were held adverse claimants and could be reached only in plenary proceedings. \textit{See Miller v. Potts}, 26 F. (2d) 851 (C. C. A. 6th, 1928); \textit{Martin v. Oliver}, 260 Fed. 89 (C. C. A. 8th, 1919); \textit{In re Dayton Coal & Iron Co.}, 291 Fed. 390 (E. D. Tenn., 1922).

\(^{27}\) \textit{See} § 67(a) (4).

\(^{28}\) Several hundred of the defrauded stockholders filed affidavits in the state court proceedings pledging their loyalty to the debtor and urging that the corporation's affairs be left in her charge.

\(^{29}\) \textit{See note} 13 \textit{supra}. 
lack of procedural machinery for investigating its financial feasibility. The power of the bankruptcy court, as a court of equity, to surrender its jurisdiction in special cases may serve as an effective means of closely circumscribing the availability of a Chapter XI proceeding as an escape from the operation of state law. The Supreme Court recently filled an obvious need in the Chandler Act by requiring the court in a Chapter XI proceeding to relinquish jurisdiction where more appropriate relief might be obtained under Chapter X. An analogous policy might appropriately be adopted to protect the administration of local law from unwarranted interference by the federal courts. In Pennsylvania v. Williams the Supreme Court recognized the authority of federal courts in equity receivership reorganizations to abandon their jurisdiction in favor of state proceedings where adequate relief might be obtained under local statutes. Although the relief provided by the Bankruptcy Act is, in theory, exclusively within federal jurisdiction, Chapter XI requires that the court, before confirming an arrangement, must be satisfied that it is "fair, equitable, and feasible," "for the best interest of creditors," and is proposed "in good faith." The broad interpretation of which the concepts are susceptible offers a convenient statutory basis for the exercise of sound discretion by the court in refusing to interfere with state proceedings. Since, however, the Chapter is designed for speed and economy, rather than the thorough reorganization provided by Chapter X, the court's power to relinquish its jurisdiction will probably be exercised sparingly unless a valid reason for doing otherwise appears on the face of the proceeding.

Resort to the equitable powers of the bankruptcy court to abandon its jurisdiction, however, is apparently unnecessary to establish the invalidity of the injunction in the instant case. Although unliquidated tort claims are generally not provable in bankruptcy proceedings, for the purposes of an arrangement under Chapter XI providing for an extension of time for the payment of debts in full, debtors may include in their plan "all unsecured

30. Compare the detailed procedure under Chapter X. See note 2 supra.
31. The possibility of repairing the defects of a somewhat poorly drafted statute through the use of the equity powers of the bankruptcy court is suggested by the opinion of Mr. Justice Stone in Securities & Exch. Comm. v. U. S. Realty & Imp. Co., 310 U. S. 434 (1940).
33. In In re Lipman, the Seventh Circuit Court of Appeals held that the bankruptcy court should in the exercise of its equity jurisdiction dismiss a petition for a composition under old § 74 which sought principally to avoid a tort judgment rendered by the state court. 78 F. (2d) 872 (C. C. A. 7th, 1935).
34. 294 U. S. 176 (1935).
35. § 366. Where, however, as in the instant case, all the creditors who are affected by the arrangement consent to a confirmation it appears that the court must be satisfied only that the arrangement and its acceptance are in good faith and have not been made or procured by any means forbidden by the Act. See § 361.
36. See Ganzan, Status of Tort Claims under the Reorganization Act (1935) 2 COMP. REOBO. 192. Claims in pending negligence actions are, however, provable under § 63(a) (7).
debts, demands, or claims of whatever character . . . whether or not provable . . . and whether liquidated or unliquidated, fixed or contingent." Had the debtor in the present case proposed a "scaling down" as well as an extension of the defrauded stockholders' claims, they might nevertheless have possibly been provable under theories of unjust enrichment. Since, however, under Sections 356 and 367, an arrangement may be confined to the alteration of the rights of a single class of creditors and bind claimants not affected by its terms, the validity of the debtor's plan was apparently not impaired by her failure to schedule the stockholders as creditors. But it does not follow that creditors not participating in the arrangement may be permanently precluded from enforcing their claims. Under Section 371 of the Act only debts "provided for by the arrangement" are discharged by the order of confirmation. Admittedly in the instant case the debtor proposed no readjustment of her liabilities to the defrauded stockholders except as the confirmation order submitted to the referee included an injunction against further action by the state court receiver. Even had the plan by its terms attempted to alter the rights of unscheduled creditors, Section 17 of the Act, incorporated into Chapter XI by Section 371, expressly exempts from discharge those claimants without notice or actual knowledge of the proceedings in sufficient time to prove their claims. By the same Section of the Act, liabilities "for obtaining money or property by false representations" are not discharged by a confirmation, even though scheduled and included in the plan of arrangement. On the basis of the state court's elaborate findings, the requirement of elements of fraud imputed into the terms of the Section may fairly be regarded as satisfied. Since then, the confirmation order was powerless, under several provisions of the Act, to discharge the stockholders' claims against the debtor, a permanent injunction against the state proceedings would appear beyond the authority of the bankruptcy court.

Notwithstanding the conclusion that the Act failed to provide for a discharge, an argument for sustaining the injunction might be found in the equitable powers of the court to protect the execution of the proposed arrangement from interference. A material amount of the debtor's property

37. § 307.
38. See Underhay, Tort Claims in Receiverships and Reorganizations (1936) 22 IOWA L. Rev. 60.
39. Although the terms of the arrangement provided for the payment of "all creditors" with the certificates to be issued by the corporation, it appears conclusive that no extension or composition of the stockholders' claims was intended since the stockholders were not scheduled as creditors and since their claims were not specifically mentioned in the plan. See Record on Appeal, pp. 21-29.
41. The findings of the state court included 49 specific types of false "pretenses, representations and promises" made by the debtor and reinforced. See Record on Appeal, pp. 106-112.
42. See Forsyth v. Vehmeyer, 177 U. S. 177 (1900).
43. Upon consummation of an arrangement the court may enter a decree "making such provisions, by the way of injunction or otherwise, as may be equitable." See § 372.
identified by the state court as derived from the proceeds of the fraudulent transactions, and thus claimed by the receiver, consisted of promissory notes which were issued by Reinforced and apparently proposed for cancellation by the two arrangement schemes. The injunction order, however, was not restricted to action by the receiver hindering the consummation of the federal proceedings. Directed toward preventing the enforcement of the state court judgment, it substantially deprived stockholders of an expedient remedy provided by state law without a concomitant discharge of their claims. However, genuinely stockholder interests were represented by the Protective Committee protesting the liquidation of corporate assets, the assumption of federal power to stalemate the judgment of the state court appears to distort the purpose of a Chapter XI proceeding, conceived to provide debtors with a method of effecting a composition or extension of their creditors' claims. Since, without a general authority in the bankruptcy court to extinguish the debtor's obligations to stockholders, the actuating purpose of the plan was frustrated, the court might have declined to confirm the proposed arrangement in order to prevent an abuse of its jurisdiction. Nevertheless a consummation of the proceedings, including a cancellation of the corporate obligations, operated only as a formal barrier to the enforcement of the state judgment; as found by the state court, in addition to the proceeds of the fraudulent transactions retained by the debtor, all the assets of the corporation and its subsidiary had been fraudulently derived. The superseding jurisdiction of the bankruptcy court, under settled theory, nullified the receiver's lien without voiding the judgment of the state court. Thus, in the absence of the injunction, the lien presumably might be reinstated and the state proceedings continued. Whichever alternative doctrine is adopted, a reversal of the present holding seems desirable to preclude escapes from state law under the authority of an inappropriate federal statute.

44. See In re Lipman, 78 F. (2d) 872 (C. C. A. 7th, 1935).
45. See Record on Appeal, p. 114.
47. In the proceedings for a corporate arrangement in the federal court in Delaware the SEC has filed motions for leave to intervene and for a dismissal of the petition. The Commission alleges that approximately 800 persons hold 116,380 shares of stock in Reinforced and that Chapter X is more appropriate for an adjustment of the corporation's obligations, particularly in view of the receivership proceedings pending in the state court. The district court has referred the motions to a referee for hearing. Since the debtor's arrangement in the instant case is contingent on the confirmation of the corporate arrangement, a Chapter X proceeding, as an alternative for a reversal of the decision of the Second Circuit Court, would probably insure a protection of the stockholders' interests.
VALIDITY OF CONTRACTS WHICH VIOLATE
REGULATORY STATUTES*

Among the contracts which will not usually be enforced in court, either by way of specific performance or by award of damages for breach, are those contemplating action in violation of a statute.1 Even where such nullity is not specifically directed by the legislature, public policy is generally thought to require it, either to punish lawbreakers by withholding societal assistance from an illegal transaction, or to maintain the integrity of the judicial process.2 At common law the doctrine was stated and applied inflexibly; providing both parties to the contract were equally aware of the illegality, it made no difference how the equities balanced between them, or whether the contract had been wholly performed on one side. The courts simply refused to act, leaving the parties where they stood.3

The administration of this rule conflicted with the more basic policy of preserving the inviolability of contracts, and frequently, too, seemed to offend equity, especially in cases where the illegality was remote, the stake large, and the defense an unconscionable technicality. To meet such situations, the courts developed various loopholes: illegality which was merely “collateral” would not void the whole contract;4 the enumeration of other penalties implied a legislative intention not to void contracts;5 penalties in revenue statutes were not intended to make taxable activity unlawful, but were designed merely to enforce payment;6 contracts involving malum in se were wholly void, while those involving merely malum prohibitum were not.7 Of all these slippery distinctions, that based on legislative “intention” seems the most reasonable; sometimes it is entirely clear whether the statute affects violating contracts. But even this criterion is no better than a blind guess by


3. The rule is frequently expressed in the maxims: ex dolo malo non oritur actio, and in pari delicto potior est conditio defendentis et possidentis. For particularly harsh applications, see National Industrial Fire Ins. Co. v. Great So. Fire Ins. Co., 177 Ky. 56, 197 S. W. 530 (1917); Overby v. Overby, 21 La. 493 (1869); Rosasco Creameries v. Cohen, 249 App. Div. 228, 292 N. Y. Supp. 9 (1st Dep't 1936); De Groot v. Van Duizer, 20 Wend. 390 (N. Y. 1838); Coules v. Pharris, 212 Wis. 558, 250 N. W. 404 (1933).


7. Ewell v. Daggs, 108 U. S. 143 (1883). When dealing with matters prohibited by statute it seems irrelevant on the issue of contractual validity whether the matter contravenes good morals or not.
the court in those many instances where the legislature has not considered the relation of a new penal statute to contract liability.

In the first such case arising under one of the New Deal regulatory statutes, the Supreme Court followed the policy recommendation of the commission which administered the statute, and indulged a presumption that contracts in violation of the law were enforceable unless it were proved that public policy or proper administration of the statute required otherwise.\(^8\) Defendant corporation had given the plaintiff an option to purchase its 1,300,000 shares of treasury stock, which plaintiff was to sell in interstate commerce, although the shares had not been registered, as required, under the Securities Act of 1933.\(^9\) The option contract also permitted defendant to make direct sales to investors and to credit plaintiff with the proceeds in excess of the option price. After several such sales, defendant refused to honor the exercise of plaintiff's option either by paying over the excess proceeds or by delivering the unsold shares. The trial court gave judgment for the plaintiff to the extent that the contract had been executed and credits between defendant and plaintiff created, but declared the option unenforceable and void as to the undelivered shares. The Idaho Supreme Court declared the whole contract void \textit{ab initio} for violation of the Securities Act and denied any recovery whatsoever.\(^10\) It is not entirely clear from the Supreme Court opinion whether, in reversing the Idaho appellate court, it approved the trial court's verdict,\(^11\) but the language of the opinion is broad enough to sustain a judgment for the plaintiff both for the executed and executory parts of his contract.\(^12\)

The Securities Act, unlike most of the other acts administered by the SEC, contains no express provisions invalidating contracts made in violation of it.\(^13\) Section 5, however, makes it "unlawful for any person, directly or indirectly," to sell or advertise securities in interstate commerce unless a registration statement is in effect. Section 24 imposes severe criminal penalties for violations, and Section 12 imposes direct civil liability in favor of invest-

\(^9\) Usually a contrary presumption is indulged, and contracts violating statutes are enforced, if at all, only by way of exception to the rule. Ewert v. Bluejacket, 259 U. S. 129 (1922); Connolly v. Union Sewer Pipe Co., 184 U. S. 540 (1902).
\(^11\) 61 Idaho 21, 98 P. (2d) 965 (1939).
\(^12\) Although the enforceability of contracts is normally a matter of state law, this case is so completely dependent upon a federal statute that probably no independent nonfederal ground exists. Dietrich v. Greaney, 309 U. S. 190 (1939); Awtin v. Atlas Exch. Bank, 295 U. S. 209 (1935); cf. Danciger v. Cooley, 248 U. S. 319, 328 (1919); Fidelity & Deposit Co. v. Grand Nat. Bank, 69 F. (2d) 177 (C. C. A. 8th, 1934).
\(^13\) The Court noted the distinction which the trial court had made but did not discuss it. The judgment of the appellate court was reversed without any qualifications. And the opinion stated broadly: "... generally, at least, what the parties have agreed to ought not to be struck down." 61 Sup. Ct. 414, 418 (U. S. 1941).
ors on those who sell in violation of Section 5. The Supreme Court viewed the defense to this action as a request for judicial enlargement of these statutory penalties. And to such a request the Court declared itself unsympathetic unless the defendant could show affirmatively that the addition of this sanction would "further the essential purpose of the enactment."  

In a brief *amici curiae* submitted by the SEC, it was argued that the normal underwriting procedure was the reverse of that in the instant case, in that the underwriter usually collects the proceeds of public sale and holds them, less commission, to the credit of the corporation. Even if securities were unregistered in this more usual situation, the SEC and the Supreme Court thought that it would be to the investors' best interest that the corporation be assisted to recover on the unlawful contract and to put the investors' money to its intended use in the business. By this hypothetical example the court was persuaded against a blanket rule of unenforceability.

While the result of the case could be justified from precedent, and is desirable from broad considerations of public policy and equity between the parties, the reasoning of the opinion, and of the SEC brief on which it was founded, seems unconvincing. In support of its presumption against the exercise of "public policy" to void contracts, the Court cites *Steele v. Drummond* 17 and *Twin Cities Co. v. Harding Glass Co.*, 18 both of which are concerned with the problem of whether there is any "public policy" in their situations—and not, as is the instant case, with the question of whether an admitted public policy against the contract should be ignored.

On the practical level of the SEC brief, the hypothetical example of an underwriter "holding out" on a corporation seems unrealistic. Most underwriting today is a direct sale, and the underwriter's liability to the issuer is perfected on the contractual closing day regardless of the amount of public resales. 19 Since the whole question is likely to arise only in cases of little-known, speculative issues, the interest of investors would seem adequately protected by the existing machinery for their individual rescission and recovery from the underwriter rather than by lending judicial aid to the consummation of an unlawful transaction. 20 And, finally, the SEC brief and the

---

14. It was argued that this transaction did not violate § 5 on the ground that it was a "transaction by an issuer not involving a public offering," exempt under § 4(1). The Idaho court and the SEC thought the exemption inapplicable here because of the clear intention to resell publicly. The Supreme Court did not rule on the issue.

15. 61 Sup. Ct. 414, 417 (U. S. 1941).

16. The SEC brief argued wholly in terms of practical results, considering as immaterial any reference to "voidness" or "illegality." In similar situations, with similar ends in view, some courts have thought it *necessary* to call a contract void in order to give a deserving plaintiff the remedy of rescission. See, *e.g.*, *Kneeland v. Emerton*, 280 Mass. 371, 183 N. E. 155 (1932).

17. 275 U. S. 199 (1927) (contract to procure necessary ordinances and franchises for a projected railroad).


19. See *DEWING, FINANCIAL POLICY OF CORPORATIONS* (3d rev. ed. 1934) 990-91, n. 1; *MOULTON, CAPITAL EXPANSION AND STABILITY* (1940) 210, 211.

20. In the case posed by the SEC brief, investors who had purchased securities from the defaulting underwriter could, without other proof than the breach of registration,
Supreme Court opinion entirely ignore the *in terrae rum* value of a judicial refusal to enforce these unlawful contracts.\(^2\)

The recent multiplication of statutes which, like the Securities Act, prohibit certain things and penalize their performance makes a restatement of legal principles on this question highly desirable.\(^2\) It does not seem possible to synthesize the doctrines in all of the many hundreds of cases collected in reference works under the head of "void" or "illegal" contracts.\(^2\) Even the use of labels to describe the conclusions reached is not consistent. Generally an "illegal" contract is one so thoroughly unlawful that the courts will not help in any way to enforce or rescind it.\(^4\) But some courts have declared contracts in violation of penal statutes to be "illegal" and "not void" at the same time—which has the effect of allowing one party to rescind the executory parts of his bargain and recover back any money already paid, though not to sue for specific performance.\(^2\) The term "void" is also used in different senses—sometimes in the strict sense of illegal,\(^2\) and sometimes to describe an unlawful contract which cannot be specifically enforced, but which, if partly executed, will be judicially unravelled to put the parties in *status quo ante*.\(^2\)

Out of the formidable mass of precedent from every American jurisdiction, two distinct judicial attitudes are discernible. New York generally follows the harshly automatic rule of the old American and the English cases that every contract involving a statutory violation is wholly unenforceable and void.\(^2\) It is apparent that this rule is one degree stricter than would be necessary to bring about a contrary result in the instant case. The Securities Act contains both a prohibition and a penalty, but under this rule the presence of a penalty alone is sufficient to void a contract.

---

\(^{21}\) See Shulman, *Civil Liabilities and the Securities Act* (1933) 43 YALE L. J. 227, 233; Comment (1940) 50 YALE L. J. 90.

\(^{22}\) See Baker, *Legislative Crimes* (1939) 23 MINN. L. REV. 135; Jones, *Excessive Law Making* (1940) 16 TENN. L. REV. 456. The latter estimates the annual production of new laws in this country as between 5,000 and 10,000.

\(^{23}\) See note 1 *supra*.


\(^{25}\) Vercellini v. United States Ind. Realty Co., 158 Minn. 72, 196 N. W. 672 (1924).

\(^{26}\) Gould v. Gould, 78 Conn. 242, 61 Atl. 694 (1905); Kellog v. Howes, 81 Cal. 170, 22 Pac. 509 (1889).


\(^{28}\) Lord Holt's rule is well known: "Every contract made for or about any matter or thing which is prohibited and made unlawful by any statute is a void contract, though the statute itself doth not mention that it shall be so, but only inflicts a penalty on the offender, because a penalty implies a prohibition, though there are no prohibitory words in the statute." Bartlett v. Vinor, Carth. 251, 252, 90 Eng. Rep. 750 (K. B. 1692). The rule is quoted with approval in Sturm v. Truby, 245 App. Div. 357, 282 N. Y. Supp. 433 (4th Dep't 1935). Cf. Rosasco Creameries v. Cohen, 249 App. Div. 228, 292 N. Y. Supp. 1 (1st Dep't 1936); De Groot v. Van Duzer, 29 Wend. 390 (N. Y. 1838).
A more liberal view has prevailed from time to time in the Supreme Court, in Massachusetts, and in some of the western states. In 1851 the Supreme Court, enforcing payment of a note given in consideration of an illegal slave sale, pointed out that diversity of legislation required a diversity of rule, and suggested that a logical distinction existed between the unlawfulness of forbidden acts and the unenforceability of private contracts involving those acts. In 1878, upholding a contract in which a National Bank took illegal security for a loan, the Court declared its independence of the letter of the statute, and made a careful investigation of legislative intent, with particular reference to the effect upon the statutory scheme of a blanket refusal to enforce illegal contracts. The leading Massachusetts case of Bowditch v. New England Mutual Insurance Co. liberalized the general rule by distinguishing statutes directory from statutes prohibitory—a distinction spurious in logic, but useful as a tool of equity. At least five or six states followed with clear holdings that where a prohibited act is not per se immoral or criminal, and the statute forbidding it is merely a business regulation, contracts for its performance are not wholly void unless expressly declared so by the legislature. This would seem the most desirable general rule, except, of course, in those cases where one party to the contract belonged to the class of direct and intended beneficiaries of the regulation, and where the rule must vary as he is either plaintiff or defendant. Similarly there seems no objection to the application of the strict rule of unenforceability where the transaction is not only in technical violation of the regulation but is intrinsically fraudulent. Since the contract in the instant case was not per se fraudulent, and did not involve, as a contracting party, an "investor," the decision is in accord with these views.

The cases arising under the various state Blue Sky laws present no consistent pattern. In the first place the statutes vary considerably. Twenty-three states provide that contracts of sale in violation of the act shall be "voidable" at the option of the purchaser; four use the word "void"; and fifteen merely provide penalties for violations without specifying the effect upon contracts. Only from the last group of states can direct analogies to the

29. Harris v. Runnels, 12 How. 79 (U. S. 1851).
32. Doherty v. McAuliffe, 74 F. (2d) 800 (C. C. A. 1st, 1935), cert. denied, 294 U. S. 730 (1935), and cases there cited. See 2 BLACK, op. cit. supra note 1, at § 318.
33. Usually the statutes specifically provide for recission in favor of the statute-beneficiary and the courts have supplied the obvious corollary that enforcement will not be granted against him. Mann v. Mann, 176 N. C. 353, 97 S. E. 175 (1918); Leininger v. Ward-Beekman, 139 Okla. 292, 282 Pac. 467 (1929); Turney v. J. H. Tilliman Co., 112 Ore. 122, 228 Pac. 933 (1924).
35. Calif., N. D., Ore., Tenn. (semble).
Securities Act be drawn—and here there is a split of authority. A majority treat violating contracts as unenforceable if still executory and subject to recission if partly performed. A minority clings to the old strict rule on "illegal" contracts and refuses to have anything to do with them. Of course the vast majority of cases in every state under the Blue Sky laws deal with situations where one party belongs to the very group for whose benefit the statute was enacted. Against such a plaintiff, "illegality" is never an adequate plea.

While it is frequently said that the courts, in these illegal contracts cases, look only to the public welfare and not to the interest of individual litigants who are party to the violation, this does not mean that the interest of the public will always be better served by non-enforcement than by enforcement. Where, for instance, a private contract runs afoul of statutory prohibition on some morally indifferent matter (and, more particularly, where the parties have only that constructive knowledge of the prohibition which is implied of all statutes), it seems a greater abuse of justice to deny equitable enforcement between the parties than to make the court an "instrument for enforcing an illegal bargain." It is also said that the non-enforceability of illegal bargains will act as a deterrent to their formation, but the contrary may be true if unscrupulous persons plan to take advantage of technical statutory violations to avoid their obligations. And in the case of statutes such as the Securities Act, which carry heavy criminal penalties, it may be doubted whether the additional sanction of contractual invalidity would have any deterrent effect at all.

As yet no cases have arisen under the federal statutes similar to the Securities Act, most of which provide that "every contract made in violation of any provision of this title, or of any rule, regulation, or order thereunder, and every contract . . . the performance of which involves the violation of . . . this title . . . shall be void." But the attitude of the SEC and of the Supreme Court in the instant case suggests that when they do, the word "void" will be interpreted to mean "subject to recission" rather than "wholly unenforceable." Such an interpretation would mean that, although executory contracts in violation of the statutes would not be enforced, recovery could be had of money passing under the contract, even where the parties were technically in pari delicto.

In a broader sense, the instant case recognizes, at least by implication, that this question is as much an issue of the market-place as of the law court.

41. See statutory provisions cited at note 13 supra.
In its deference to the judgment of the administrative body, and its refusal to be bound by rigid rules of "void" and "illegal" contracts, the Court has set a valuable example. Mindful of a constantly increasing flood of regulatory legislation carrying penal sanctions, courts should feel today not that every penalty makes private contracts void, but merely that the penalty indicates the general nature of the public policy.

THE SHERMAN ACT AS A CLEAN HANDS DEFENSE*

Ever since the advent of the Sherman Act\(^1\) illegal restraints of trade by a plaintiff have been raised as a "clean hands" defense in equitable actions.\(^2\) To sustain this defense, a defendant had to prove that the particular restraint of trade of which the plaintiff was allegedly guilty was directly connected with the matter in issue, or, to put it conversely, that the claim which the plaintiff asserted arose out of the allegedly unlawful combination.\(^3\) Because of the difficulty of establishing this proposition, the clean hands defense based on anti-trust law violations was seldom successful.\(^4\)

Recently, however, a specially constituted three judge district court has seen fit to allow the defense without requiring the usual strict proof of its applicability.\(^5\) The American Society of Composers, Authors and Publishers\(^6\) brought an action to enjoin an allegedly unconstitutional Washington statute\(^7\) designed to regulate the manner in which the Society licenses its copyrighted music for public performance.\(^8\) KMO, Inc., a Washington radio broadcasting station, intervened and moved to dismiss the suit on the ground that the Society constituted a monopoly in violation of the Sherman Act and therefore had no standing to sue in a court of equity. The court assumed

42. See Gellhorn, Contracts and Public Policy (1935) 35 Col. L. Rev. 679.

---

\(^2\) For general treatment of the clean hands maxim, see I POMEROY, A TREATISE ON EQUITY JURISPRUDENCE (1918) §§ 397-404, MCCLINTOCK, EQUITY (1936) § 24.
\(^3\) See note 26, infra.
\(^4\) See page 1116 infra, discussing the two situations where the defense has been successful.
\(^6\) For a discussion of the recent history of ASCAP, see Cohn, Music, Radio Broadcasters and the Sherman Act (1941) 29 GEORGETOWN L. J. 407.
\(^7\) 5 WASH. REV. STAT. § 3802 (Remington Supp. 1940). This is one of the eight anti-ASCAP statutes which have been passed to date. See Cohn, supra note 6, at 416. Three have been declared unconstitutional. Buck v. Swanson, 33 F. Supp. 377 (D. Neb. 1939); Buck v. Harton, 33 F. Supp. 1014 (M. D. Tenn. 1940); Buck v. Gibbs, 34 F. Supp. 510 (N. D. Fla. 1940). See Comment (1940) 53 HARV. L. REV. 458.
\(^8\) The statute prohibits the Society from operating in Washington if it continues its present system of blanket licensing but provides that it may operate if it puts its rates on a per piece basis. The statute also requires registration of all copyrighted compositions with prices to be charged. See Cohn, supra note 6, at 418.
that every Sherman Act violation justified invocation of the clean hands doctrine, and found that since the Society's activities unquestionably came under the interdiction of the Act, the motion to dismiss should be granted.

As authority for the clean hands doctrine the court relied on two Supreme Court cases decided more than half a century apart. Neither involved restraints of trade; both merely restated the familiar rule that a court of equity will not enforce claims arising out of fraudulent transactions. Inasmuch as the Society's claim that the Washington statute was unconstitutional could hardly be considered as arising out of its alleged illegal practices, which in no sense can be classified as fraudulent, it would seem that the court's authorities fall far short of establishing its statement that "if the Society exists in violation of the Sherman Anti-trust Act, . . . it, and the members composing it, are not entitled to a decree for its benefit."

Viewed in the light of the general proposition that a statutory violation is a clean hands defense, the court's statement fails to conform to the usual judicial standards. Prefatory to such an invocation of a statutory wrong, a defendant must prove that the wrong is directly connected with the matter in suit. In addition, the defendant must show that the plaintiff's violation has prejudiced him in some special way, or that judicial relief would sanction or perhaps extend the plaintiff's illegal activities. Judged by these standards, the violations with which the Society is charged should not bar relief in equity. In the first place, even assuming arguendo that the Society's alleged violations directly concerned the matter in suit, they cannot be said to have prejudiced the state of Washington in any special way. Violation of a federal statute does not ipso facto injure one of the several states. Furthermore, if the Society's activities in Washington had been considered in restraint of trade, presumably the Attorney General against whom the injunction was sought would have invoked the Washington anti-trust laws.

In the second place, the district court would not necessarily be protracting the Society's allegedly illegal activities by permitting it to challenge the Washington statute, for a decision either sustaining or invalidating the statute would but slightly affect the Society's nationwide activities.

---

11. The clean hands defense has been invoked in the case of many types of statutory violations. Strand Amusement Co. v. Owensboro, 47 S. W. (2d) 710 (Ky. 1932) (Sunday law); Ad-Lee Co. v. Meyer, 294 Pa. 498, 144 Atl. 540 (1928) (gambling); Cornellier v. Haverhill Shoe Mfrs' Ass'n, 221 Mass. 554, 109 N. E. 643 (1915) (use of illegal methods in strike).
15. 4 WASH. REV. STAT. § 2382 (Remington 1932).
16. See Cohn, supra note 6, at 410-412.
The considerations which move equity to deny use of the clean hands defense in the case of an ordinary statutory violation become even more significant where the Sherman Act is raised as the equitable defense. The Sherman Act is an instrument designed to enable the Government to curb monopolistic restraints through criminal\textsuperscript{17} or equitable\textsuperscript{18} proceedings and to enable individuals to recover treble damages in private actions;\textsuperscript{19} its exclusive remedies include dissolution of illegal combinations but preclude the confiscation of property. Hence, since a corporation convicted under the Sherman Act does not lose its legal entity,\textsuperscript{20} in subsequent patent,\textsuperscript{21} trademark,\textsuperscript{22} or copyright\textsuperscript{23} infringement suits the courts have never permitted infringing defendants to deprive the plaintiff-corporation of such property rights by means of the clean hands defense.\textsuperscript{24} From this it follows that since non-compliance with the Washington statute spelled forfeiture of the Society's copyrights\textsuperscript{25} —its major property rights— the same rule of law should have governed the principal case.

Two exceptions, however, have been made to this settled rule against the use of the Sherman Act as a clean hands defense. One is where the defendant is able to show special damage apart from the damage suffered by the general public as a result of the plaintiff's monopolistic practices —this damage, of course, being directly connected with the right upon which the plaintiff is suing.\textsuperscript{26} The second exception is where a contract in issue arises out of the illegal combination.\textsuperscript{27} Inasmuch as the principal case neither involves a contract nor presents an issue of special damage to the defendant, it is hardly possible to rely on these exceptions to the settled rule against the use of the Sherman Act as a clean hands defense.

\begin{itemize}
  \item \textsuperscript{17} 26 Stat. 209 (1890), 15 U. S. C. §§ 1-3 (1934).
  \item \textsuperscript{20} Weyman-Bruton Co. v. Old Indian Snuff Mills, 197 Fed. 1015 (S. D. N. Y. 1912).
  \item \textsuperscript{21} General Electric Co. v. Wise, 119 Fed. 922 (C. C. N. D. N. Y. 1903).
  \item \textsuperscript{22} Searchlight Gas Co. v. Prest-o-Lite Co., 215 Fed. 692 (C. C. A. 7th, 1914).
  \item \textsuperscript{24} Similarly, the courts have generally refused to permit the defense where the specific performance of a contract was in issue in order, in the words of Mr. Justice Holmes, “to prevent people from getting other people's property for nothing when they purport to be buying it.” Continental Wall Paper Co. v. Voight, 212 U. S. 227, 271 (1909).
  \item \textsuperscript{25} 5 Wash. Rev. Stat. §§ 3802-8 (Remington Supp. 1940).
  \item \textsuperscript{26} See Radio Corp. of America v. Hygrade Sylvania Corp., 10 F. Supp. 879, 881-2 (D. N. J. 1934); Radio Corp. of America v. Majestic Distributors, 53 F. (2d) 641, 643 (D. Conn. 1931).
\end{itemize}
In addition to the legal considerations which militate against the court's decision in the principal case, the evidentiary methods by which the court determined the Society's breach of the Sherman Act cast even stronger doubts on the decision. Though a Sherman Act prosecution was pending against the Society at the time of the instant proceeding, there was no \textit{prima facie} case that the Society had violated the Act. In fact, even if there had been a prior criminal conviction, it would not have been admissible under established practice as conclusive evidence of the essential facts. Moreover, the court could not presume a confession of guilt. Therefore, to prove the completeness of the Society's monopoly, the court was compelled to fall back on a statement of facts in another district court opinion, on the dissenting opinion of Mr. Justice Black in \textit{Gibbs v. Buck}, and on the testimony of the operators of two Washington radio broadcasting stations taken by a special master. In contrast to the voluminous evidence taken in the usual anti-trust suit, this evidence was fragmentary and hardly of sufficient probative value to justify a conclusion of violation of the statute. In fact, it has been said that determinations of this nature are so highly questionable that the clean hands defense should not apply in such cases.

But aside from the inapplicability of the clean hands doctrine, the principal case raises the collateral issue of whether the Society was accorded due process.

\begin{notes}
28. The criminal prosecution, begun on August 30, 1934, was indefinitely postponed by mutual consent of the parties in June, 1935. On Dec. 27, 1940, the Department of Justice announced that it would begin new criminal proceedings against ASCAP, its rival, Broadcast Music, Inc., and the two major networks, Columbia and National. Cohn, supra note 6, at 407-8. A consent decree was consummated when ASCAP signed on February 20, 1941. See (1941) 9 U. S. L. WEEK 2514.

29. See (1941) 50 YALE L. J. 409.

30. The Society argued before the court that its activities were not in violation of the Sherman Act. Plaintiff's Reply Brief, pp. 15-17, Buck v. Gallagher, 36 F. Supp. 405 (W. D. Wash. 1940).

31. See Buck v. Swanson, 33 F. Supp. 377, 386 (D. Neb. 1939), where the court said: "Of the popular music necessary for the successful operation of radio stations, dance halls, hotels and theaters, the society has control of about 85% to 90% and also has control of from 50% to 75% of the standard or older music that is played occasionally." The court declared the Nebraska anti-ASCAP statute unconstitutional.

32. 307 U. S. 66, 82 (1939), where he said: ". . . [The Society's] power over the business of musical rendition is so great that it can refuse to sell rights to single compositions, and can, and does, require purchasers to take, at a monopolistically fixed annual fee, the entire repertory of all numbers controlled by the combination."

33. "In the instant case the testimony of the operators of two of the largest radio broadcasting stations in Washington was that it would be impossible to operate such stations without the music controlled by the Society. The Society has neither submitted evidence, nor made argument to the contrary." Buck v. Gallagher, 36 F. Supp. 405, 405 (W. D. Wash. 1940). But the court does not state for what purpose the evidence was taken.

34. \textsc{Hamilton & Till, Antitrust in Action} (TNEC Monograph No. 16, 1940) 58-74.

\end{notes}
of law. By virtue of enormous penalties for violation of the statute,\textsuperscript{36} the Society under the rule in \textit{Ex parte Young}\textsuperscript{37} had a constitutional right to challenge the validity of the statute without being subject to the penalties. But the use of the clean hands defense effectively destroys the usefulness of the protection afforded by the \textit{Young} doctrine. Such an attempted circumvention was denounced by the Supreme Court in \textit{McFarland v. American Sugar Refining Co.}\textsuperscript{38} There the defense interposed to an attack on a state statute aimed at a reputed monopoly of the complainant was that the complainant had been convicted of a Sherman Act violation. The Court characterized the statute as similar to a "bill of pains and penalties," because "the statute was passed in view of the plaintiff's conduct, to meet it."\textsuperscript{39} Similarly, in the principal case, the statute under attack was passed specifically to combat ASCAP. The words of Mr. Justice Holmes in the \textit{McFarland} case seem, therefore, particularly apt. In speaking of the apparent connection between the asserted defense and the purpose of the assailed statute, he observed: "We deem it enough to say that neither that supposed connection nor the general intimations of the plaintiff's wickedness in the answer deprive it of its constitutional rights or prevent it from asserting them in the only practicable and adequate way."\textsuperscript{40}

Apart from this constitutional issue, which in itself exemplifies an improper use of the clean hands doctrine, the principal case may be said to represent an unwarranted extension of this ancient doctrine.\textsuperscript{41} Since the doctrine was never intended to punish litigants for their collateral crimes, it would seem that use of Sherman Act violations as a clean hands defense — as in the case of other statutory violations — should be restricted to situations where the defendant has suffered some special damage or where to grant the plaintiff a remedy would promote his illegal activities. Furthermore, in view of the desirability of adequate proof in anti-trust litigation, it seems preferable generally not to permit Sherman Act violations to be tried as a side issue. Such sparing use of the Sherman Act as a clean hands defense would best meet the demands of the Act and the functional limitations of the doctrine.

\begin{itemize}
  \item \textsuperscript{36} 5 \textit{Wash. Rev. Stat.} \textsuperscript{5} § 3802-8 (Remington Supp. 1940) provides for forfeiture of copyrights; 5 \textit{Wash. Rev. Stat.} \textsuperscript{5} § 3802-10 (Remington Supp. 1940) provides a fine not exceeding $500 or imprisonment for not more than six months, or both, for each violation.
  \item \textsuperscript{37} 209 U. S. 123, 165 (1908). In \textit{Gibbs v. Buck}, 307 U. S. 66, 77 (1939), the Court held that the heavy penalties of the Florida anti-ASCAP statute entitled the Society to equitable relief under the rule in \textit{Ex parte Young}.
  \item \textsuperscript{38} 241 U. S. 79 (1916).
  \item \textsuperscript{39} \textit{Id.} at 85.
  \item \textsuperscript{40} \textit{Ibid.}
  \item \textsuperscript{41} It should be stated, however, that some courts have occasionally gone far afield in use of the clean hands defense and reached results as unorthodox as that of the principal case. See, e.g., \textit{Knights of the K. K. K. v. Strayer}, 34 F. (2d) 432 (C. C. A. 3d, 1929); \textit{American University v. Wood}, 294 Ill. 186, 128 N. E. 330 (1920); \textit{A. N. Chamberlain Medicine Co. v. H. A. Chamberlain Medicine Co.}, 43 Ind. App. 213, 86 N. E. 1025 (1909).
\end{itemize}
THE CONTRACTUAL LIABILITY OF TRUSTEES

Adherence to the ancient doctrine that trustees are personally liable on trust contracts with third parties has frequently resulted in judicial disregard of the plain intention of trustee and contracting party. The trustee, in the absence of an express disavowal of liability, has been held subject to a judgment at law collectible from his personal property, although the third party may have known that the contract was negotiated for the benefit of a cestui que trust and although the fiduciary may have signed in his representative capacity. The original purpose of thus imposing upon the trustee an unintended liability was to grant the third party a remedy in a law court which, refusing to recognize the trust device, would allow recovery only against the trustee personally as the holder of legal title to the trust property. Presently the rule is said to function to safeguard the beneficiary's interest by imposing liability upon the trustee in the first instance and allowing the latter reimbursement only in an accounting.

It is possible, of course, for the third party to reach the trust estate directly in an equitable action. While no suit against the estate is cognizable at law, equity has granted him direct relief on a theory of subrogation, allowing him satisfaction to the extent of the trustee's right of indemnity from the trust estate, and on a theory of unjust enrichment, providing him with relief measured by the benefit received by the trust estate from the transaction. He can also obtain a decree forcing the trustee to apply trust property to the satisfaction of the contractual obligation. These equitable actions, not exclusive

---


1. This doctrine is applied to administrators, executors, and guardians as well as to trustees; to business trusts as well as personal trusts; to cases of *intra vires* as well as *ultra vires* contracts; and has been accepted in a majority of United States jurisdictions. Taylor v. Davis, 110 U. S. 330 (1884); O'Brien v. Jackson, 167 N. Y. 31, 60 N. E. 238 (1901); Bogert, *Trusts* (1935) §712; Scott, *Trusts* (1939) §262; Restatement, *Trusts* (1935) §262. This doctrine is hereinafter referred to as the strict rule of trustee liability.

2. There are two ways in which a trustee may contract out of liability: (a) a stipulation that the third party will look only to the trust estate; (b) an agreement that the third party will look only to the trustee's right of indemnification from the trust estate. The former, if valid, will give the third party an equitable remedy against the estate, the latter a right in personam against the trustee. Scott, *op. cit. supra* note 1, § 271; Warren, *Corporate Advantages Without Incorporation* (1929) 854; Williston, *Contracts* (rev. ed. 1936) 915. That a trustee may so contract, see cases cited by authorities *supra* note 1.


5. These actions are fully discussed by Scott, *op. cit. supra* note 1, §§ 267 et seq.
sively available to the third party and unsatisfactory where the trust estate is insolvent, substitute only infrequently for the typical direct suit against the trustee personally.

The stringency of the doctrine which allows recovery against the trustee personally in an action at law has been somewhat alleviated by equity courts and trust settlors, each anxious to mitigate the obligations legally assumed by a trustee upon acceptance of fiduciary duties. Curative relief is provided in equity by the trustee's right of reimbursement from the trust estate when the contract upon which he has been held is one made within the scope of his authority for the cestui's benefit. This right may be negligible, however, if at time of suit the trust property is insufficient to furnish complete reimbursement. Equally haphazard is the preventive relief provided by a settlor's insertion within the trust indenture of an exculpatory clause properly defining the limits of the trustee's liability. This clause will exert no protective force unless the trustee contracts in such manner as to put the third party on notice of its existence.

Opportunity to reconsider these established postulates was recently presented to the New York Court of Appeals in *East River Savings Bank v. 245 Broadway Corporation*. In 1927 Sophie Samuels established an irrevocable trust of a single plot of mortgaged property for her own and her children's benefit, naming four trustees, each of whom was a defendant in the present action. By the declaration of trust, the trustees were expressly empowered further to mortgage the property; and a clause of the declaration stated that "the trustees shall not receive any compensation for their services but shall not be liable for any damage or otherwise, except for misconduct or gross negligence." Within a year of their acceptance of the trust, the trustees increased the first mortgage indebtedness by $30,000, the plaintiff bank agreeing both to make the advance and to extend the time of the entire loan. In every instrument concerned with this transaction, the defendants identified themselves "as Trustees under a Deed of Trust dated . . . and recorded" and all signed in their representative capacity "as Trustees above mentioned." In no instrument was there an express stipulation exempting the trustees from personal liability. Default having occurred, the plaintiff bank, after judgment of foreclosure, sought a deficiency judgment against


7. See p. 1122 *infra*.


10. The property was encumbered by a first mortgage of $250,000 and a second mortgage of $75,000, neither of which was assumed by the defendants. The second mortgage was subordinated to the consolidated first mortgage and presented no issue to the court in the instant case.
the trustees personally. The Special Term of the Supreme Court, adhering to the settled rule that in the absence of express disclaimer of liability trustees are personally obligated on trust contracts irrespective of intentions not to be bound, allowed the deficiency judgment against the defendants. The Appellate Division affirmed. The Court of Appeals held for the defendants on the theory that the trustees as a class and not individually signed contracts which, incorporating by reference pertinent provisions of the trust declaration, placed plaintiff on notice of the trustees' restricted liability under the exculpatory clause.

The opinion, thus primarily premised on the ground of exculpatory clause exemption, seems unconvincing, for it depends upon a doubtful construction of the clause. The court is apparently correct in stating that the plaintiff bank was on notice of the trust declaration. The words of identification employed by defendants in the papers relating to the mortgage extension would seem to be sufficient reference to the trust declaration to place the bank on notice of all its provisions, including the exculpatory clause. Moreover, the court might have used the presumption that a trustee ordinarily has no inherent power to mortgage the trust estate, in order to impose upon the bank as mortgagee an obligation to ascertain this authority when the mortgagor signed in a representative capacity. Fulfillment of this obligation would have given notice to the bank of that clause authorizing a mortgage


14. For purposes of exemption from trustee liability, the words used by defendants would doubtless be deemed descriptio personae and of no legal effect. Duvall v. Craig, 2 Wheat. 45 (U. S. 1817). Any clause used must be clear and unequivocal: "as trustee" will be considered purely descriptive but "as trustee and not individually" will allow exemption. Bogert, op. cit. supra note 1, § 714. The distinction so made has been criticized. See Warren, op. cit. supra note 2, 861. Negotiable Instruments Law § 20 allows an exception in the case of bills and notes which Uniform Trusts Act § 12 proposes to extend to all trust contracts. See p. 1124 infra.


by the trustees and, by inference, of all clauses of the trust declaration, including the exculpatory provision. Under either view, however, it does not necessarily follow that the exemption from liability is here applicable. The exemption, appearing as it does with the compensatory provision, relates only to an agreement between trustee and beneficiary. It contains no reference to strangers, usually included by the broad provisions of more accurately drawn exoneration sections, and should constitute no warning to the bank that payment of the indebtedness would be forthcoming only from the trust estate. Had the clause referred to third parties, the bank could have maintained an action in equity against the trust estate.

Whatever its reasoning, the court did obtain a desirable result in sparing the trustees pecuniary responsibility. Had the strict rule urged by the dissent been applied, the uncompensated trustees would have suffered irreparable loss, for their right to reimbursement terminated with the exhaustion of the trust estate when the mortgage on the estate was foreclosed. Nor does the result appear to place an undue burden on the bank, which was fully aware of the nature of the mortgage transaction. The bank was careful to make its checks payable to the defendants as trustees; it investigated the credit standing of the trust, not the trustees; and it brought this action for the trustees' personal liability only after amendment of its original complaint, which sought recovery from the trust estate through the defendants as trustees.

In the light of these equities, a decision applying the strict rule of trustee liability but allowing the trustees a reimbursement action against the cestuis, as distinguished from the trust estate, would have been possible. Precedent for thus relieving the trustees by a circuitous route could have been found 17. A carefully constructed exculpatory clause should include a provision that "all having transactions with the trustees are on notice that the trustees are not personally liable" or a similar provision. This is usually the case in business trust indentures. See Baker v. James, 280 Mass. 43, 181 N. E. 861 (1932); Dolben v. Gleason, 292 Mass. 511, 198 N. E. 762 (1935). Such a provision may have no effect, however, if the exculpatory clause also instructs the trustees to specify in each contract that the trust estate alone shall incur liability and the trustees fail so to specify. Review Printing & Stationery Co. v. McCoy, 291 Ill. App. 524, 10 N. E. (2d) 506 (1937), (1938) 36 Mich. L. Rev. 1184.

18. It might well be argued that to give effect to the exculpatory clause in the principal case is to bind a third person by a contract to which he was not a party. See Pumelly v. Phelps, 40 N. Y. 59 (1869). But cf. Gwin v. Fountain, 159 Miss. 619, 126 So. 18 (1930).

19. Aside from the exculpatory clause, the court placed some emphasis on the fact that the four trustees acted as a group and not individually. But the trustees could have acted in no other way, for when the administration of a personal trust is vested in cotrustees, matters requiring judgment and discretion must be effected by joint action. See Colburn v. Grant, 181 U. S. 601, 606 (1901); Winslow v. Baltimore & O. R. R., 188 U. S. 646, 655 (1903); Brennan v. Willson, 71 N. Y. 502 (1877). Only in ministerial affairs, or where concert of performance is excused by statutory or trust provision, will the act of one of a group of cotrustees be binding. There was neither a statutory nor a trust provision excusing joint action in the principal case.

in a group of English cases\textsuperscript{21} which afford the trustee an action in equity against the beneficiary for indemnification when the former incurs liability in the proper administration of the trust and his right to reimbursement is frustrated by the insufficiency of the trust estate.\textsuperscript{22} While the English cases are premised upon the equitable maxim that he who reaps the benefits bears the burdens, a contractual theory—inferring a promise by the cestui to reimburse the trustee—is available when, as here, a beneficiary of the trust is also its settlor.\textsuperscript{23}

No American court, however, has specifically accepted these English cases,\textsuperscript{24} and there are dicta indicating that a theory placing a burden of reimbursement upon the cestui is untenable in this country.\textsuperscript{25} This notion is based, not so much on the fact that the function of the trust device is to preserve unimpaired the beneficiary’s interest, as on the restrictive view that since the trustee may disclaim personal liability either upon acceptance of the trust or at the time of contracting with a third party, failure so to disclaim forces full responsibility upon him.\textsuperscript{26} An additional basis for this conclusion is the practical consideration that the trustee, by being in control of the trust estate, always has the means of risk avoidance entirely within his hands. A trustee’s suit for reimbursement against a cestui may also be defeated by recognition of the lack of control exercised by the cestui, a factor which prevails in the

\begin{itemize}
  \item Balsh v. Hyham, 2 P. Wms. 453, 24 Eng. Rep. 810 (1728); Phene v. Gillan, 5 Hare 1, 67 Eng. Rep. 803 (1845); \textit{Ex parte} Chippendale, 4 DeG. M. & G. 19, 54, 43 Eng. Rep. 415, 428 (1854); \textit{In re} The Exhall Coal Co., 35 Beav. 449, 55 Eng. Rep. 970 (1866); \textit{In re} National Financial Co., 3 Ch. App. 791 (1869); Hardoon v. Belilos, [1901] A. C. 118, 14 Han. L. Rev. 539; Matthews v. Ruggles-Brise, [1911] 1 Ch. 194. None of these cases, however, involved a typical testamentary or \textit{inter vivos} trust; all were concerned with trusts for business purposes.
  \item The English doctrine is not without exception: trustees of an unincorporated club have been held to have no right to reimbursement from the club members. Wise v. Perpetual Trustee Co., Ltd. [1903] A. C. 139, noted (1903) 3 Col. L. Rev. 407; Williams, \textit{Club Trustees’ Right to Indemnity: A Criticism of Wise v. Perpetual Trustee Co., Ltd.} (1903) 19 L. Q. Rev. 386; Book Review (1903) 17 Harv. L. Rev. 141.
  \item See Scott, \textit{supra} note 6, 728. In the case of business trusts, by definition, it is usual for the cestuis to be the settlors. Warren, \textit{op. cit. supra} note 2, 323. See Poland v. Beal, 192 Mass. 559, 78 N. E. 728 (1906).
  \item And the authorities are in conflict over the English doctrine. In favor of the doctrine: Bogert, \textit{op. cit. supra} note 1, § 718; Perry, \textit{Trusts and Trustees} (7th ed. 1929) § 485. Against the doctrine: Scott, \textit{op. cit. supra} note 1, § 262; Loening, \textit{A Trustee’s Handbook} (Shattuck Rev. 1940) 241. Caveat: \textit{Restatement, Trusts} (1935) § 265.
Further objections to the English doctrine's allocation of reimbursement risk on the beneficiary lie in its circuity and also in its ineffectiveness in those instances where the cestui, as well as the trust estate, is without funds.

The shortcomings of the English doctrine and, at the same time, the difficulties inherent in rigid application of the strict rule of trustee liability may be obviated by a greater readiness on the part of courts to find from ambiguous exculpatory clauses and contracts omitting express disclaimers of liability an intent to avoid personal liability. Had the court in the principal case accepted the argument of defendants, this attitude would have been established in New York and the strict rule, whose inflexible character ignores the practical realities of trust administration, would have been repudiated. The scope of intent, now only as broad as a trustee's contractual stipulations against liability, could thus have been extended not only to encompass a greater effective range but also to shift the risk currently placed on trustee to trust estate and third party. This broader view of intent already obtains in the field of negotiable instruments through Section 20 of the N. I. L., which deems a trustee prima facie not liable when he signs in his representative capacity and discloses his principal. This section was drafted to counteract judicial doctrines at variance with mercantile usage. By Section 12(3) of the Uniform Trusts Act, now adopted in two states, the policies in respect to bills and notes are extended to all trust contracts. Present business practice appears to call for this less stringent rule. It is difficult to believe that a business man contracting with a trustee, who discloses his capacity but does not disclaim personal liability, immediately relies on the individual resources of the trustee, rather than on the estate.

The establishment of this practical view of intent and the repudiation of the strict rule of trustee liability appear inevitable, for the ancient doctrine

27. Frost v. Thompson, 219 Mass. 360, 365, 106 N. E. 1009, 1010 (1914); Mecham, Partnership (2d ed. 1920) §98.
29. There are decisions intimating such an attitude. See those cited in Brief for Defendants-Appellants, pp. 7-12, East River Savings Bank v. 245 Broadway Corp., 284 N. Y. 470, 31 N. E. (2d) 906 (1940); Scott, op. cit. supra note 1, §§263, 271A. Parol evidence may be introduced to describe the circumstances attendant upon the negotiations and execution of a written instrument. Richardson, Evidence (4th ed. 1931) §444.
30. See Brannan, Negotiable Instruments Law (6th ed. 1938) 295-300, 312-316. Trustees are included within the section's ambit by the words "or in a representative capacity."
32. The section provides that "the addition of the word 'trustee' or the words 'as trustee' after the signature of a trustee to a contract shall be deemed prima facie evidence of an intent to exclude the trustee from personal liability."
has now outgrown its former usefulness and continuous application con-\ntravenes present day policies. The amalgamation of law and equity has de-\nstroyed the initial function of the strict rule—to grant to the contracting\nthird party a remedy in a court of law which refused to recognize the trust\ndevice.\n
Those courts, moreover, which continue to adhere to the strict rule as security for the beneficiary’s interest fail to realize that, upon adoption of\nthe more practical rule, the cestui would still have an action for breach of\ntrust in the case of an unauthorized contract and that, where the contract is properly negotiated, the beneficial interest requires no protection.\n
Furthermore, the strict rule, by affording the contracting third party indemnity\nfrom two sources—the property of trust and trustee—unduly favors the third\nparty in an arm’s length transaction. In view of these considerations, no rea-\nson appears to compel rigid adherence to the strict rule.

LATERAL SUPPORT FOR EXISTING BUILDINGS DURING NEW CONSTRUCTION\n
In urban communities excavation of ground below the foundation depth\nof adjoining buildings necessitates lateral support of foundation walls by\nshoring or underpinning. The bulk of decisions concerning lateral support\nhave been directed at fixing the damage liability for injuries arising from\ninadequate support. Comparatively little regard has been given to the prob-\nlem of designing affirmative rules to compel the party legally responsible for\ndamages to take precautionary measures so that no building injury can occur.

In attempting to solve the problem of liability courts have used two essen-\ntially different sets of legal doctrines—the “natural right” doctrines of prop-\nerty and the more flexible negligence doctrines of tort law. Originally \n“property” law exclusively governed the imposition of all liability for injury both to land and buildings. The courts, following a seventeenth cen-\nty dictum, charged all excavators with absolute liability for damage to\nadjacent land in its natural condition but placed the loss from damage caused\nby the removal of additional support necessary for buildings on the building\nowner himself.\n
In an era when the abundance of land and the relatively

34. This action would, of course, be dependent on the trustee’s financial position.
35. By definition, that which the trustee does, within the scope of his authority, is\ndone for the beneficiary’s interest. Section 12(2) of the UNIFORM TRUSTS ACT allows\nthe beneficiary to intervene in an action against the trustee as trustee in order to object\nto collection from the trust estate.

* Braun v. Hamack, 206 Minn. 572, 289 N. W. 553 (1940).
1. Wilde v. Minsterley, 2 Roll. Abr. 564 (1639); see (1929) 15 CORN. L. Q. 123.
2. Obert v. Dunn, 140 Mo. 476, 41 S. W. 901 (1897); Schaefer v. Hoffman, 198\nWis. 233, 223 N. W. 847 (1929); see 3 TIFFANY, PROPERTY (3d ed. 1939) §§ 752, 753;\n(1929) 15 IOWA L. REV. 88; (1937) 15 N. C. L. REV. 394. In some jurisdictions the absolu-\ntrate right to the lateral support of land may be lost where the superimposed weight of\nbuildings increases the necessity of lateral support. Smith v. Stolle, 77 S. W. (2d) 521\n(Mo. App. 1940).
small size of buildings made lateral support for neighboring structures normally unnecessary, this rule was satisfactory. Its inequity in a modern society, however, where heavy buildings are often constructed contiguous with adjoining property lines has necessitated exceptions within the field of property law; the excavator, for example, has been held liable for building injury where the soil in its natural state would have fallen even without the superimposed weight of the buildings.

Tort doctrines have been used to greater effect in imposing responsibility upon the excavator, placing on him in some cases the duty to shore adjoining buildings during excavation. Though most courts generally refuse to impose such an unqualified tort liability, many have supported jury verdicts against excavators whose failure to protect adjoining buildings was so obviously negligent as to make the fall of a building certain. Thus used, the concept of negligence has great flexibility in determining whether an excavator may be held for injury to adjoining buildings; and if this concept were combined with a flexible application of contributory negligence, which as yet has undergone comparatively little development in this field, the absolute manner

3. It has been said that a landowner may not, by building a massive superstructure on his own land, substantially increase the cost of his neighbor’s subsequent excavation. See Neyman v. Pincus, 82 Mont. 467, 487, 267 Pac. 805, 810 (1928). It may be said with equal validity, however, that a man may not, by excavating to a great depth on his own land, put his neighboring building owner to the great expense of shoring up his property. Canfield Rubber Co. v. Leary, 99 Conn. 40, 49, 121 Atl. 283, 286 (1923); see Note (1927) 50 A. L. R. 486, 489.

4. A person excavating contiguous to a party wall for the purpose of building a new wall must insure the adjoining owner against damage to the party wall. Christensen v. Mann, 187 Wis. 567, 596, 204 N. W. 499, 509 (1925). The right to adjoining support for party walls has been held to arise either by grant or prescription. Carroll Blake Constr. Co. v. Boyle, 140 Tenn. 166, 173, 203 S. W. 945 (1918). The existence of a party wall by grant has been sufficiently supported by evidence that the adjoining lands with the wall were conveyed by a common owner to the excavator and the adjoining owner. Nippert v. Warneke, 128 Cal. 501, 61 Pac. 96 (1900). A case similar in fact and legal result occurs where a building and lands have been conveyed by a common owner to one party and adjacent lands to another. Durante v. Alba, 266 Pa. 444, 446, 109 Atl. 796 (1920).


10. 6 Restatement, Torts, Explanatory Notes (Tent. Draft No. 14, 1925) 101. Some courts have held that an infirm condition of adjoining buildings does not constitute
in which even present property doctrines operate irrespective of the varying situations could be supplanted. The risk of building injury can be placed equitably only by reference to some specified standard of land utilization to which all landowners will be held. The party, excavator or owner, not using his property in the specified desirable manner must assume the risks of building injury. In view of the current intense but varying land uses, the flexible tort doctrines indicate a more realistic solution to the problem of assigning responsibility than either anachronistic and absolute property rules based on a natural use of land, or their absolute exceptions.  

Tort procedure, though more desirable than the property concepts, is not, however, completely satisfactory because of its uncertain operation. Some attempt to avoid both the uncertainties of tort law and the inadequacies of placing absolute liability on either building owner or excavator under property doctrines has been made through statutes which set an arbitrary excavation depth as the point at which the loss in building damage shifts from building owner to the excavator. Though framed with reference to the customary use of land, such statutes may prove unsatisfactory even to effect this standard since they are invariably statewide in application; the customary depth of foundations may vary greatly between different cities, because of the hardness of the soil or the size of the buildings. Recognition and effect have been given to these local differences, however, by the use of municipal ordinances to set the critical building depth.


11. The American Law Institute pictures the law of lateral support as growing out of two different theories of property law—i.e., that the right to support is either a "natural easement" or a "right to the integrity of land." 4 Restatement, Torts (1939) 185-186. From each of these the Institute has "deduced" a different group of five legal results. The concepts and their logical implications are of little value, however, in analyzing the cases, in arguing for a particular result in a given case, or in determining what is a desirable result, since the circularity of these terms permits a similar result under either. The Institute has made little inquiry into determining a sound reason for supporting property law rules and has not considered the desirability of supplanting property law with the more flexible tort doctrines.

12. Such uncertainty makes it impossible to determine in advance on whom the loss for damaged buildings lies so that such person may be forced to take precautionary measures; and the vicissitudes of a jury trial give no assurance that all landowners will be held either to the same or even to a desirable standard of land utilization.


14. Cleveland Mun. Code (1924) § 1535(c)(d) (nine feet); Los Angeles Mun. Code (1936) § 91.149 (twelve feet); Pittsburgh Mun. Dig. (1938) § 923(2) (fifteen feet). In some cities the burden shifts not only if the actual depth of the foundation exceeds the set limit, but also if there is an intention in the building plans to exceed this depth. New Haven Bldg. Code (1925) § 18(1)(2); Foster v. Zampieri, 140 App. Div. 471, 125 N. Y. S. 422 (1910) (ordinance of City of New York). In a few cities the
provide an additional refinement by fixing one depth at which the burden shifts for a dwelling house and another for a business structure. Moreover, some ordinances, concerned primarily with distributing the cost of shoring, make an excavator responsible only where the adjoining foundation walls have been extended to the specified depth limit by the owner. Probably a more complete method of imposing the responsibility for lateral support, and a method toward which these ordinances point, would be their control by local planning commissions which could lay down rules for each city, assessing the burden with reference to the depth of foundations in different areas and with reference to the kind of land use which it is desirable to keep at a low cost. The most satisfactory solution to the problem of lateral support, however, probably lies in long range land use planning in which congested cities will disappear.

If an excavator is to be held liable for failure to provide temporary support for adjoining buildings, it is not difficult to compel him to take adequate precautionary measures to protect buildings adjoining excavations. Thus, some courts have put a positive preventive duty on the excavator by enjoining at the request of the building owner an attempt by the former to excavate without providing lateral support. A similar result is obtained by the revocation of the excavator’s building permit by a municipal officer acting under a local building code.

Such a facile solution for the problem of inducing affirmative action to prevent building injuries becomes inoperative when the liability shifts to the adjoining owner. To some extent withholding damages from an owner for injury to his own property and assessing damages against him for injury to the excavator caused by the building’s collapse will induce preventive action. Some owners, however, may prefer to take an unreasonable risk of not shoring their buildings. As a recent case illustrates, the courts have

entire burden of support is on the excavator. BALTIMORE CITY CODE (1928) art. 3, §22(4); TULSA BLDG. CODE (1931) §207(b). In almost all situations, however, the duty of support will remain with the owner unless he gives the excavator license to enter his premises. BALTIMORE CITY CODE (1928) art. 3, §§14(11), 22(6). CINCINNATI BLDG. CODE (1933) §1900-5. A few ordinances give the excavator an absolute right of entry to adjoining property. TULSA BLDG. CODE §207(b). Notice of an intended excavation is usually necessary, as at common law, to create any duty of the building owner to protect his own property. BUFFALO ORD. (1939) c. XII, §72.

15. SPOKANE GEN. ORD. (1928) ord. C1891, §67 (six and twelve feet).
16. BUFFALO ORD. (1939) c. XII, §72; CLEVELAND MUN. CODE (1924) §1534(d); LOS ANGELES MUN. CODE (1936) §91.149. Ordinances shifting to the excavator the total burden of protecting a house with inadequate foundations may be quite inequitable. See TRIULZI v. COSTA, 296 Mass. 24, 4 N. E. (2d) 617 (1936) (Boston ordinance).
18. See BIRMINGHAM GEN. CODE (1930) §301; LOS ANGELES MUN. CODE (1936) §91.05; NEW HAVEN BLDG. CODE (1923) §7(7); TRIULZI v. COSTA, 296 Mass. 24, 4 N. E. (2d) 617 (1936).
19. DAVIS v. SAP, 20 Ohio App. 180, 152 N. E. 758 (1922); EGGERT v. KULLMANN, 204 Wis. 60, 234 N. W. 349 (1931).
20. See, e.g., OBER v. DUNN, 140 Mo. 476, 41 S. W. 901 (1897) (destruction of $6000 building because $12 instead of $126 precautionary expense was incurred).
refused to compel the building owner to shore his property in accordance with general building standards. The excavation of the plaintiff had caused the ground under defendant's house to begin to slip away. Upon investigation the building inspector of Minneapolis determined that the defendant's building, contrary to the city building code, had no foundations. Pursuant to his authority to declare buildings unsafe or in contravention of the provisions of the building ordinances, he ordered defendant to build proper foundations for the house. Upon the latter's refusal the plaintiff-excavator, in order to insure the safety of his own work, was compelled to build the foundations, and attempted to recover their cost from the adjoining owner. In denying recovery the court reasoned that though the owner himself could recover no damages from the excavator, to whom in fact he was under a potential liability, still the owner could not be compelled to protect his own property. Since there was no duty, there could be no implied request for the excavator's expense and, therefore, no quasi-contractual recovery. A similar result in favor of the owner would presumably have followed an attempt of the excavator to obtain a mandatory injunction directing the owner to protect his own property.

The court's argument that there can be no recovery because there is no duty is unconvincingly circular; the building owner has no duty only if the excavator may not recover the expense of providing foundations. Such a conclusion rests on an assumption that protection of property is of concern only to the owner, and denies any social interest in the preservation of existing structures. The courts themselves have adopted a contrary view in analogous fields where they continually reassert the desirability of rules tending to increase new construction, and the same policy should favor protec-

23. The court said explicitly only that the plaintiff was a volunteer; but his classification under this status necessarily implies that the owner had no duty to protect his own property and prevent injury to others. The court's view seemed to be motivated by the inequity of granting the excavator damages for an expense occasioned by his own activity. See (1940) 24 Minn. L. Rev. 852; (1940) 88 U. of Pa. L. Rev. 1020. Such a repudiation of the strict common law rule of placing the burden of temporary support on the owner could be much more desirably effected by placing a duty of support on the excavator directly.
24. There have been similar holdings in other jurisdictions. *First Nat. Bank v. Villegra*, 92 Cal. 96 (1891); *Korogodsky v. Chimberoff*, 256 Ill. App. 255 (1930); *Flanagan Bros. Mfg. Co. v. Levine*, 142 Mo. App. 242, 125 S. W. 1172 (1910). Where, however, there has been immediate danger to the lives of the excavator's workmen, the excavator has recovered his costs. *Cefarrelli v. Landino*, 82 Conn. 126, 72 Atl. 564 (1909); see Flanagan Bros. Mfg. Co. v. Levine, *supra* at 247, 125 S. W. at 1173. Though the court in the principal case thus asserted the contractor's ability to recover for the shoring or underpinning during an "unavoidable urgency," it in fact denied recovery where the facts would have justified such a finding.
26. See CLARK, REAL COVENANTS AND OTHER INTERESTS WHICH RUN WITH LAND (1929) 58.
tion of existing structures. Even aside from any question of the wisdom of putting a common law duty on an owner to protect his own property, the municipal duty imposed by the building inspector's order in the principal case should have been conclusive in allowing recovery. 27 This the court ignored in the face of a strong dissent. 28

Express ordinances in some municipalities are available to prevent the result of the principal case. These ordinances impose a duty on the adjoining building owner similar to that imposed by the building inspector's order in the principal case. They direct variously that the building owner "shall support and protect" his walls "so as to preserve" them "safe and secure," 29 that he "shall protect and underpin" his walls "so that they shall be and remain as safe as before such excavation was commenced," 30 or that he "shall preserve and protect" his building "by proper foundations." 31 To insure performance of this duty by a recalcitrant building owner, various sanctions are provided. The most extreme are stipulations that the excavator after ten days notice shall shore up the building and recover his expense from the owner; 32 other ordinances provide that after either 24 or 48 hours notice the city building inspector may take any necessary measures to protect the building. 33 In the latter case either the city or any person, including the excavator, who shores the owner's property under the inspector's direction may recover from the owner in the same manner as if the owner had requested the work. Finally, other ordinances give a right to shore and recover only to the city. Though this may necessitate an additional crew of workmen for some excavations, it does provide adequate protection for the building owner's property. 34

Though these municipal procedures may adequately forestall building injury, there is danger that a court intent on protecting a building owner's right to the delapidation of his own property may declare them void. In passing ordinances a municipal corporation has only those powers impliedly or expressly granted it by the legislature or the state constitution, 35 and some courts have held that municipal corporations may change the common law only where the specific change has been authorized by legislative enabling acts.

27. Weisberger v. Maurer, 9 N. J. Misc. 117, 120 (1931), aff'd on lower court opin-
ion, 109 N. J. Law 273, 160 Atl. 634 (1932) (a duty imposed by an ordinance was similarly overlooked).


29. Pittsburgh Mun. Dig. (1938) § 923(2); see also Buffalo Ordinances (1939)
c. XII, § 72; St. Louis Rev. Code Ann. (1938) § 4670.


31. Administrative Code of the City of New York (1938) § 26-385.0(b); see also Cleveland Mun. Code (1924) § 1535(c).


34. Buffalo Ord. (1939) c. XII, § 72; Pittsburgh Mun. Dig. §§ 923(4), 881 (re-
quires an action in Common Pleas Court previous to action by the city); Spokane Gen. Ord. (1928) ord. C1891, § 67.

35. 2 McQuillan, Municipal Corporations (2d ed. 1939) § 708.
or constitutional provision.\textsuperscript{36} Such a view prohibits a common law change under either implied grants of power or general grants empowering a municipality to enact laws inconsistent with state policy. Thus, some courts have declared void a municipal ordinance attempting to shift common law liability for building injury from owner to excavator at a specified excavation depth, even when under legislative grant the municipality could provide all building regulations necessary to protect health and safety.\textsuperscript{37} In a similar manner, where ordinances change common law by imposing a positive duty on adjoining building owners, they may be construed as void in the absence of an express legislative enabling act.

The general validity of the rule requiring an express grant of power to change the common law is, however, open to doubt.\textsuperscript{38} Whenever express legislative grant is found unnecessary, the power to pass an ordinance imposing a public duty of self-protection on building owners may easily be premised on the usual legislative grant to municipalities to “provide for the safe construction, inspection and repair of all private and public buildings within the city.”\textsuperscript{39} Even in the absence of this general enabling clause a city usually has the additional power to provide ordinances necessary to the general municipal welfare;\textsuperscript{40} and though the community value in an equitable incidence of excavation costs may be questionable, its stake in the maintenance of private structure in a safe condition is clear.

So far as prevention of social waste is concerned, the immediate desirability of rules to insure building protection seems apparent, especially where the burden of the prevention is on a recalcitrant building owner. To some extent courts can protect such an owner’s property by awarding an excavator his expense in providing the necessary underpinning and shoring. Probably the most effective solution to the problem, however, lies in municipal regulations under which an unbiased municipal officer may, in the event of the owner’s refusal to act, determine both the necessary precautionary measures and the most desirable means of carrying them out at the owner’s expense.

\textsuperscript{36} Carroll Blake Const. Co. v. Boyle, 140 Tenn. 166, 179, 203 S. W. 945, 948 (1918); Hickman v. Weller, 169 Wis. 18, 24, 171 N. W. 635, 638 (1919).


\textsuperscript{38} McKelley v. Murfreesboro, 162 Tenn. 304, 309, 36 S. W. (2d) 99, 100 (1931) (rule held not infringed where its application was undesirable); cf. Matter of McIntosh v. Johnson, 211 N. Y. 265, 105 N. E. 414 (1914).

\textsuperscript{39} See Carpenter v. Reliance Realty Co., 103 Mo. App. 480, 494, 77 S. W. 1004 (1903) (Charter of St. Louis).