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## EFFECT OF SECTION 3 (a) (10) OF THE SECURITIES ACT AS A SOURCE OF EXEMPTION FOR SECURITIES ISSUED IN REORGANIZATIONS

ALTHOUGH the chief purposes of the Federal Securities Act<sup>1</sup> are to deter the fraudulent flotation of securities and to provide the purchasing public with information upon which to base a judgment in choosing investments,<sup>2</sup> the Act acquires additional significance when applied to securities issued in the course of a reorganization, whether those securities are certificates of deposit issued by a protective committee, or definitive securities issued by the new or reorganized corporation. For not only does the Act operate to protect the public at large from the irresponsible flotation of worthless securities via the reorganization route, but incidentally, it also serves in part to protect the existing holders of the reorganizing corporation from the abuses to which they have sometimes

1. 48 STAT. 74 (1933), as amended by 48 STAT. 905 (1934), 15 U. S. C. A. § 77 (a-a) (1935).

2. See Douglas and Bates, *The Federal Securities Act of 1933* (1933) 43 YALE L. J. 171, 172; Comment (1935) 44 YALE L. J. 456, 457.

been subjected.<sup>3</sup> This dual protection is to be afforded by the requirement that information be filed concerning the issuance of the securities and the affiliations of the issuers, the accuracy and completeness of that information to be assured by the imposition of liabilities for falsifications or omissions. But these provisions are undoubtedly burdensome,<sup>4</sup> and it appears to be part of the policy of the Act that they should not be imposed where adequate supervision is otherwise supplied. For Section 3 (a) (10) provides an exemption for certain reorganization issues which are directly supervised by a judicial or administrative body.<sup>5</sup> Implicit in this exemption is the theory that direct supervision constitutes an adequate substitute for enforcing compliance with the Act.<sup>6</sup> The soundness of this premise depends, of course, largely on the thoroughness and ability with which the supervision is carried out. It is the purpose of this Comment, first, to determine when, and from what bodies the supervision requisite to exemptions under Section 3 (a) (10) may be available, and secondly, in the light of that determination, to appraise the efficacy of the supervision thus afforded as a substitute for the sanctions of the Securities Act.

The situations where exemptions under Section 3 (a) (10) may prove necessary are rather numerous. A reorganization, using that term in its broad sense,<sup>7</sup>

3. For expositions of the abuses prevalent in reorganizations, see LOWENTHAL, *THE INVESTOR PAYS* (1933); Lowenthal, *The Railroad Reorganization Act* (1933) 47 HARV. L. REV. 18, 19, 20; Comment (1935) 35 COL. L. REV. 905. But cf. Douglas, *Protective Committees in Railroad Reorganizations* (1934) 47 HARV. L. REV. 565.

4. The trouble, expense and liability attendant upon compliance with the Act is a serious problem to reorganizers who usually are faced with difficulties enough in other connections. See Ballantine, *Amending The Federal Securities Act* (1934) 20 A. B. A. J. 85, 86; Dodd, *Reorganization Through Bankruptcy: A Remedy For What?* (1935) 48 HARV. L. REV. 1100, 1119, 1120; Fried, *The Effect of Section 77B On Real Estate Reorganizations* (1935) 4 BROOK. L. REV. 310, 318; Wehle, *Railroad Reorganizations Under Section 77 of the Bankruptcy Act: New Legislation Suggested* (1934) 44 YALE L. J. 197, 203; Legis. (1934) 34 COL. L. REV. 1348. The situation in regard to protective committees has been eased somewhat by the elimination of individual liability of committee members. 48 STAT. 905 (1934), 15 U. S. C. A. § 77 b (4) (1935).

5. The section exempts "any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court, or by any official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval . . ."

6. Compare the negative implication contained in the following statement referring to Section 4(3) of the old Securities Act: "Reorganizations carried out without judicial supervision possess all the dangers implicit in the issuance of new securities and are, therefore, not exempt from the act. For the same reason the provision is not broad enough to include mergers or consolidations of corporations entered into without judicial supervision." See H. R. Rep. No. 85, 73d Cong., 1st Sess., 133 C. C. H. § 2162.02.

7. The term "reorganization" is sometimes applied only to a readjustment of a corporation's financial structure necessitated by threatened or actual insolvency. See DEWICK, *FINANCIAL POLICY OF CORPORATIONS* (3d ed. 1934) 1086, 1087. The term is here used, however, to mean any readjustment of a corporation's financial structure, including merger,

may be accomplished in a variety of ways. A list of the more important methods would include the following: a voluntary scaling down of the corporate debt structure pursuant to an agreement among the security holders; an exchange of new stock for existing shares of the same corporation; a sale of the corporate assets to another corporation; a statutory merger or consolidation; a sale of the corporate assets resulting from a foreclosure by entry or under a power of sale provided for in a mortgage or deed of trust; a judicial sale of the corporate assets to another corporation, typically in foreclosure; a reorganization under a state statute; and a judicial proceeding under Section 77 or 77B of the Bankruptcy Act.<sup>8</sup> Any of the foregoing methods of reorganization frequently involves the issuance or exchange of two types of securities which may be subject to the Securities Act. First, it has very frequently proved expedient to centralize the interests of the security holders during the proceedings by setting up protective committees, which solicit the deposit of securities, issue certificates of deposit in exchange, and thereafter exercise the rights of their depositors in regard to the reorganization;<sup>9</sup> secondly, definitive securities of the new or reorganized corporation must ordinarily be issued. The issuance or exchange of both the certificates of deposit and the definitive securities, or in some cases even the solicitation thereof,<sup>10</sup> necessitates the filing of a registration statement with the Securities and Exchange Commission unless the securities are in some way exempt from the Securities Act.<sup>11</sup> While other exemptions are occa-

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consolidation, etc. Cf. Rules and Instructions Accompanying Form E-1, 133 C. C. H. § 7231 (5).

8. For descriptions of these various devices, see DEWING, *op. cit. supra* note 7, at 1083 et seq.; 15 FLETCHER, *CYCLOPEDIA OF CORPORATIONS* (1932) §§ 7200-7294; GLENN, *LIQUIDATION* (1935) §§ 421-433; PAYNE, *PLANS OF CORPORATE REORGANIZATION* (1934) 1-61; Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares* (1931) 19 CALIF. L. REV. 349; Lowenthal, *supra* note 3; Weiner, *Corporate Reorganization: Section 77B of The Bankruptcy Act* (1934) 34 COL. L. REV. 1173; Comment (1935) 45 YALE L. J. 105.

9. The activities of protective committees have frequently been discussed. See, for example, CRAVATH in STEYSON AND OTHERS, *SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION* (1930) 153, 162-174; ROHRLICH, *LAW AND PRACTICE IN CORPORATE CONTROL* (1933) 65-95; TRACY, *CORPORATE FORECLOSURES* (1929) § 309; Carey and Brabner-Smith, *Studies In Realty Mortgage Foreclosures* (1933) 28 ILL. L. REV. 1, 3-11; Comment (1935) 35 COL. L. REV. 905; and see authorities cited *supra*, note 8.

10. A registration statement regarding certificates of deposit must be in effect before the solicitation of deposits. See Note to Form No. D-1, 133 C. C. H. § 6901. Registration in connection with the issuance of definitive securities must precede the promulgation of the reorganization plan, if the plan is submitted by, or with the consent of the prospective issuer of securities under the plan, and if those assenting or failing to dissent will be bound. Rules and Instructions Accompanying Form E-1, 133 C. C. H. § 7231(3).

11. See Legis. (1934) 34 COL. L. REV. 1348. Registration would apparently be unnecessary as to definitive securities issued to existing stockholders of a corporation in pursuance of a sale of assets or merger or consolidation provided for by statute or charter, if a majority vote of the stockholders would effectuate and make binding the plan or agreement involved. See Rules and Instructions Accompanying Form E-1, 133 C. C. H. § 7231, (5) Note. But a somewhat ambiguous statement by the Commission makes it doubtful whether this would be true if the new securities were issued partly in exchange for old

sionally available,<sup>12</sup> recourse will often be had to Section 3 (a) (10).

In order to gain exemption under that Section, the following requirements must be fulfilled: 1) the securities must be issued in exchange for other securities, or partly in such exchange and partly for cash; 2) there must be a hearing on the fairness of the terms and conditions of such exchange before any court, or before any official or agency of the United States, or before any state or territorial banking or insurance commission or other governmental authority expressly authorized by law to perform this function;<sup>13</sup> 3) notice must be given to all persons to whom it is proposed to issue securities, and they must have the right to be heard;<sup>14</sup> 4) the body conducting the hearing must approve the fairness of the terms and conditions of the proposed exchange—in the case of certificates of deposit, approval of the deposit agreement is apparently sufficient,<sup>15</sup> while in regard to definitive securities, approval of the reorganization

securities and partly for cash. *Id.* (6). Registration is likewise unnecessary in regard to certificates of deposit issued pursuant to proceedings under Section 77B provided that the deposit of securities involved merely constitutes "approval" or "acceptance" of the reorganization plan for the purposes of Section 77B, and provided depositors are not bound to pay expenses. S. E. C. Release No. 296 (Class C) Feb. 15, 1935, 133 C. C. H. § 2162.08. Some committees are using this device to avoid registration, but it weakens the committee's position. See Dodd, *supra* note 4, at 1120. Many have obtained exemptions under Section 3 (a) (10) instead. See Spaeth and Friedberg, *Early Developments Under Section 77B* (1935) 30 ILL. L. REV. 137, 146, 147.

During 1935, 135 reorganization issues were registered through 105 registration statements. The statements covered securities having an approximate value of \$133,402,379. See S. E. C. Release No. 634, Table X, Jan. 23, 1936.

12. The more important exemptions concerning reorganization issues are as follows: (1) Both definitive securities and certificates of deposit issued in a railroad reorganization under Section 77 of the Bankruptcy Act are exempted by that section. 47 STAT. 1474, as amended by 49 STAT. 911, 11 U. S. C. A. § 205 (f) (1935). (2) Definitive securities and certificates of deposit issued subsequent to confirmation of the reorganization plan in proceedings under Section 77B of the Bankruptcy Act are exempted by that section. 48 STAT. 920 (1934), 11 U. S. C. A. § 207 (h) (1935). This does not exempt certificates of deposit issued prior to confirmation of the plan. S. E. C. Release No. 296, Feb. 15, 1935, 133 C. C. H. § 2162.08; see Legis. (1934) 34 COL. L. REV. 1348, 1351. (3) Section 3 (a) (9) of the Securities Act exempts "Any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange." It has been indicated that "commission or other remuneration" means something other than expenses for printing, clerical salaries, etc. See 133 C. C. H. § 2161.03. But the exemption is narrow. For in large reorganizations, commissions are usually paid for solicitation. See Legis. (1934) 34 COL. L. REV. 1348, 1355, n. 51. And certificates of deposit would not be included since they are not exchanged with the existing security holders of the committee.

13. General Counsel of the Commission has indicated that the words "expressly authorized by law" do not apply to courts, or to officials or agencies of the United States. With the possible exception of a state banking or insurance commission, however, a state governmental authority must have clear and explicit statutory authorization to hold hearings on the fairness of the terms and conditions of the exchange, from the standpoint of the investors, issuer, and consumers involved, and to approve or disapprove the same. *Op. of Gen'l Counsel*, S. E. C. Release No. 312 (Class C), March 15, 1935, 133 C. C. H. § 2162.07.

14. See *Op. of Gen'l Counsel*, *supra* note 13.

15. See letter to Goldwater and Flynn, Aug. 24, 1934, 133 C. C. H. § 2162.05.

plan pursuant to which they are to be issued is necessary.<sup>16</sup> Accordingly, the bodies which may grant exemptions under Section 3 (a) (10) must have jurisdiction both to afford hearings at which the prospective recipients of securities have the right to be heard, and to approve the fairness of deposit agreements or reorganization plans as the case may be.<sup>17</sup> The problems may be discussed conveniently with reference first to the courts, and secondly, to administrative bodies.

#### COURTS

The fundamental problem involved in considering the power of the courts to afford exemptions by passing upon the fairness of reorganization plans and deposit agreements is that this function has an administrative rather than a judicial aspect. Difficulties are presented in the form of various interrelated concepts, such as the necessity that there be a controversy between two parties over the fairness of the plan or agreement,<sup>18</sup> that the court's decision will establish and fix the jural relations of the parties,<sup>19</sup> that the judgment be coupled with some form of coercive execution,<sup>20</sup> and that the effect of the judgment will not be nullified by the action of another branch of the government.<sup>21</sup> In some cases, the issue as to the fairness of a reorganization plan might be brought partially within these traditional modes of thought. For example, a creditor who would otherwise be cut off from enforcing his claim against the corporate assets by a judicial sale may nevertheless enforce his claim if the sale is made pursuant to an unfair plan of reorganization.<sup>22</sup> Likewise, a stockholder who would otherwise be bound may sometimes set aside or enjoin action leading to a radical change in the corporate existence, such as a stockholders' sale of the corporate assets, or a merger or consolidation, if the plan involved is unfair.<sup>23</sup> Again, it is

16. Occasionally the reorganization plan is contained in the deposit agreement. This should not alter the requirements for the exemption of either class of securities. But as will appear in the text, the power of some bodies to render their approval is clearer in the case of a reorganization plan than of a deposit agreement. In such cases, approval of an agreement containing a reorganization plan might be more readily obtainable than an approval of the deposit agreement alone. Cf. *Matter of Prudence Bonds Corp.*, No. 26545 (E. D. N. Y., Sept. 14, 1934); *Legis.* (1934) 34 *COL. L. REV.* 1348, 1353, n. 42.

17. Presumably, the Commission would rule that an approval was ineffective to afford an exemption if it was rendered by a body considered by the Commission to lack the necessary jurisdiction.

18. See Arnold, *Trial By Combat And The New Deal* (1934) 47 *HARV. L. REV.* 913.

19. See BORCHARD, *DECLARATORY JUDGMENTS* (1934) 6.

20. See *Liberty Warehouse Co. v. Grannis*, 273 U. S. 70, 73, 74 (1927); *Guaranty Trust Co. v. Chicago, M. & St. P. Ry. Co.*, 15 F. (2d) 434, 440 (N. D. Ill. 1926). This concept, however, has been exploded. See BORCHARD, *op. cit. supra* note 19, at 9, 10.

21. See FRANKFURTER AND KATZ, *CASES ON FEDERAL JURISDICTION AND PROCEDURE* (1931) 1-24. Cf. note 17, *supra*.

22. *Northern Pacific Ry. v. Boyd*, 228 U. S. 482 (1913).

23. *Eagleson v. Pacific Timber Co.*, 270 Fed. 1008 (D. Del. 1920) (sale of assets); *MacArthur v. Port of Havana Docks Co.*, 247 Fed. 984 (D. Me. 1917) (sale of assets); *Outwater v. Public Service Corporation*, 103 N. J. Eq. 461, 143 Atl. 729 (1928), *aff'd* without opinion, 104 N. J. Eq. 490, 146 Atl. 916 (1929) (merger); see Rohrlich, *Suits In Equity By Minority Stockholders As A Means Of Corporate Control* (1933) 81 U. or

possible that an attempt to issue new stock in return for old shares of the same corporation might be enjoined if the exchange would modify unfairly the relative rights of different classes of stockholders in the corporate property.<sup>24</sup> Accordingly, in such cases, the fairness of the reorganization plan may present a controversial issue in regard to which a judicial decision will fix certain jural relations of the interested parties. But at the time the court's approval of the plan is sought for exemption purposes, such a controversy might be regarded as too remote a possibility to present a proper case for decision.<sup>25</sup> And in other instances even a potential controversy seems lacking. For example, in a voluntary scaling down of the corporate debt structure, where an individual non-assenting creditor would not be barred by the reorganization from enforcing his claim against the corporate property, no justiciable controversy over the plan would seem to be presented, since a court decision that the plan was fair would not affect the legal relations of the parties. This is likewise true of a deposit agreement, the fairness of which appears to constitute no more of a justiciable issue than the fairness of any other contract.<sup>26</sup> Moreover, in the case of a deposit agreement, an additional obstacle exists, for either exemption or registration must precede the solicitation of deposits.<sup>10</sup> Consequently, a committee seeking exemption would ordinarily have no depositors, and hence, at the time exemption was sought, no one would appear to have an interest in contesting the fairness of the agreement, even if it were otherwise justiciable. The extent to which the courts may be said to have the necessary jurisdiction regardless of these conceptual difficulties depends largely on the type of proceedings in which the hearing and approval is sought. The situations where resort to the courts may prove necessary are roughly divisible into three groups: first, where the exchange of securities or the solicitation thereof is to occur during judicial proceedings which are not provided for by some special statute; second, where the exchange or solicitation is

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PA. L. REV. 692, 708-713; Comment (1935) 45 YALE L. J. 105, 114-120. The last-cited Comment points out at page 119 that it is not always clear whether unfairness alone, in the absence of fraud, is a sufficient basis for court action.

24. See Rohrlich, *supra* note 23, at 702-705.

25. "An investigation' is a proceeding unknown to a court of justice, either in law or in equity. Courts sit and hear evidence in order to adjudicate the rights of parties actually or potentially before them. They do not preside over mere investigations, grounded either on curiosity or as merely preliminary to a (possible) future suit." *Parker v. New England Oil Corporation*, 13 F. (2d) 158, 163 (D. Mass. 1926); see *Guaranty Trust Co. v. Chicago, M. & St. P. Ry. Co.*, 15 F. (2d) 434, 440 (N. D. Ill. 1926); cf. BORCHARD, *op. cit. supra* note 19, at 40-50.

26. Disputes concerning deposit agreements have sometimes arisen, usually involving a depositor's right to withdraw, or to have the committee removed. But the courts have rather uniformly treated the agreements as contracts to be "construed" or "rescinded" on the usual grounds, and fairness has apparently not been considered as an operative fact. See, e.g., *Habirshaw Electric Cable Co. v. Habirshaw Electric Cable Co., Inc.*, 296 Fed. 875 (C. C. A. 2d, 1924); *Jewett v. Commonwealth Bond Corp.*, 241 App. Div. 131, 271 N. Y. Supp. 522 (1st Dep't, 1934) (committee removed for "breach of trust"). In *Harrigan v. Pounds*, 147 Misc. 666, 264 N. Y. Supp. 363 (Sup. Ct. 1933), the court discussed the one-sidedness of the deposit agreement at considerable length, thus indicating that its unfairness affected the rights of the parties. But this decision was reversed. 239 App. Div. 1, 265 N. Y. Supp. 676 (1st Dep't, 1933).

to take place while judicial proceedings in accordance with some special statute, such as Section 77 or 77B, are under way; and third, where it is to occur at a time when no judicial proceedings are in progress.

1. *Equity Receivership.* The typical non-statutory reorganization in the federal courts, and to a lesser extent in the state courts,<sup>27</sup> is carried out while the corporation is in equity receivership.<sup>28</sup> The desired readjustment may be effected by a foreclosure or receiver's sale,<sup>29</sup> a judicial decree fixing the rights of the parties,<sup>30</sup> or a voluntary readjustment of the corporate financial structure without a judicial sale or decree.<sup>31</sup> Whatever the method employed, the receivership courts have, in the past, proved themselves capable of developing new remedies and of disregarding to some extent the traditional concept of a controversy in dealing with reorganizations.<sup>32</sup> Accordingly, it appears probable that they

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27. In real estate reorganizations in the state courts, it is often desirable to utilize merely a foreclosure action without receivership in order to save expense. See Carey, Brabner-Smith and Sullivan, *Studies In Realty Mortgage Foreclosures* (1933) 27 ILL. L. REV. 849, 852; Comment (1934) 34 COL. L. REV. 706, 711.

28. See GLENN, *op. cit. supra* note 8, § 430. While this device will be displaced to a large extent by the new bankruptcy machinery, it will probably not disappear entirely. *Ibid.*; see Sabel, *The Corporate Reorganization Act* (1934) 19 MINN. L. REV. 34, 54; Sabel, *Equity Jurisdiction In The United States Courts With Reference To Consent Receiverships* (1934) 20 IOWA L. REV. 83, 100, 101. Indeed, where receivership and foreclosure proceedings have been consolidated, there may be some difficulty in transferring the proceedings to a bankruptcy court. See Comment (1936) 30 ILL. L. REV. 627.

An alternative method of reorganization was afforded by the bankruptcy courts even before the recent amendments, but it was unsatisfactory and little used. See GLENN, *op. cit. supra* note 8, § 429; Friendly, *Some Comments On The Corporate Reorganization Act* (1934) 48 HARV. L. REV. 39, 46, 47; Jackson, *An Analysis of Section 77B* (1936) 2 CORR. REORG. 267, 269. It will probably be totally supplanted by Section 77B. GRANOR, *CORPORATION LAW FOR OFFICERS AND DIRECTORS* (1935) 637. It should perhaps be noted, however, that considerable doubt existed as to whether a bankruptcy court had jurisdiction to pass on reorganization plans. Cf. *In re Witherbee*, 202 Fed. 896 (C. C. A. 1st, 1913); *In re Northampton Portland Cement Co.*, 185 Fed. 542 (E. D. Pa. 1911); see Friendly, *supra*, at 47.

29. See, e.g., *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U. S. 445 (1926) (foreclosure sale); *Bethlehem Steel Co. v. International C. E. Corp.*, 66 F. (2d) 409 (C. C. A. 2d, 1933) (receiver's sale); *Hauer v. Appalachian Gas Corporation*, 19 Del. Ch. 283, 167 Atl. 839 (1933) (receiver's sale). But the Supreme Court has invalidated a receiver's sale where the corporation was highly solvent and not affected with a public interest. *First National Bank v. Flershem*, 290 U. S. 504 (1934).

30. *Phipps v. Chicago, R. I. & P. Ry. Co.*, 284 Fed. 945 (C. C. A. 8th, 1922). This case has been both criticized and supported. See *Harding v. American Sumatra Co.*, 14 F. (2d) 168 (N. D. Ga. 1926); Rosenberg, *Phipps v. Chicago, Rock Island & Pac. Ry. Co.* (1924) 24 COL. L. REV. 266, n. 1; Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade* (1927) 27 COL. L. REV. 901.

31. *Jennings v. Fidelity & Columbia Trust Co.*, 240 Ky. 24, 41 S. W. (2d) 537 (1931); *Park v. Grant Locomotive Works*, 40 N. J. Eq. 114, 3 Atl. 162 (1885); cf. *Parker v. New England Oil Corporation*, 4 F. (2d) 392 (D. Mass. 1924); see TRACY, *op. cit. supra* note 9, § 314. In *Moore v. Splittdorf Electrical Co.*, 114 N. J. Eq. 358, 168 Atl. 741 (1933), a stockholders' sale was apparently attempted while the corporation was in receivership.

32. See Arnold, *supra* note 18, at 930; Billig, *Corporate Reorganization: Equity vs. Bankruptcy* (1933) 17 MINN. L. REV. 237.

will assume jurisdiction to meet the newly felt need for exemptions under Section 3 (a) (10).

The rendition of approvals of reorganization plans for exemption purposes would not be a great extension of the powers which courts have already developed. For they have frequently considered the fairness of reorganization plans for other purposes. Thus, where a judicial sale is involved, it is clear that the federal courts have the power to pass on the fairness of the plan in considering whether a sale should be confirmed,<sup>33</sup> and a few decisions indicate that the state courts will adopt this rule.<sup>34</sup> But courts have sometimes refused to exercise this power before the sale, on the theory that at that early stage the question is moot, since it is uncertain that the plan will ever be effectuated, and since the court's judgment will not be enforced by any coercive execution.<sup>35</sup> Other courts, however, have refused to admit that they can function only *ex post facto*, and have considered the plan at earlier stages in the proceedings.<sup>36</sup> A reorganization accomplished through a court decree likewise contemplates that the court will pass upon the fairness of the plan. Indeed, this method is valid, if at all, only if the plan is thoroughly examined.<sup>37</sup> And where a voluntary reorganization is effected during receivership, it also appears possible to obtain judicial approval of the plan regardless of the apparent lack of a justiciable controversy.<sup>38</sup> One

33. *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U. S. 445 (1926); *Bethlehem Steel Co. v. International C. E. Corp.*, 66 F. (2d) 409 (C. C. A. 2d, 1933); see PAYNE, *op. cit. supra* note 8, at 57-61; Swaine, *supra* note 30.

34. *Eastern States Public Service Corporation v. Atlantic Public Utilities*, 17 Del. Ch. 338, 156 Atl. 214 (1931); *Hauer v. Appalachian Gas Corporation*, 19 Del. Ch. 283, 167 Atl. 839 (1933); *Chase Nat. Bank v. 10 East 40th Street Corp.*, 238 App. Div. 370, 264 N. Y. Supp. 882 (1st Dep't, 1933); *De Betz's Petition*, 9 Abb. N. C. 246 (N. Y. Sup. Ct. 1878). Furthermore, a New York court has considered this proper even in a foreclosure action unaccompanied by receivership. *Clinton Trust Co. v. 142-144 Joralemon Street Corporation*, 237 App. Div. 789, 263 N. Y. Supp. 359 (2d Dep't, 1933). It has been stated that the state courts, with the exception of New York, have steadfastly refused to take cognizance of reorganization plans. QUENDRY, BONDS AND BONDHOLDERS (1934) § 341 (e). And it is considered doubtful by some how far the New York courts will extend the practice. See Fried, *supra* note 4, at 315, n. 21. But even where courts have refused to exercise jurisdiction over reorganization plans, they have not expressly denied its existence. See Comment (1934) 34 COL. L. REV. 706, 711. The scarcity of cases in which the jurisdiction has been exercised is perhaps explainable by the fact that attempts to obtain state court supervision have been infrequent. See Carey and Brabner-Smith, *supra* note 9, at 11.

35. See *Conley v. International Pump Company*, 237 Fed. 286, 287, 288 (S. D. N. Y. 1915); *Guaranty Trust Co. v. Chicago, M. & St. P. Ry. Co.*, 15 F. (2d) 434, 440 (N. D. Ill. 1926); Swaine, *supra* note 30, at 910.

36. The opinion in *Guaranty Trust Co. of New York v. Missouri Pac. Ry. Co.*, 233 Fed. 812 (E. D. Mo. 1916) indicates that it is proper, and often desirable, to hold the hearing on the plan at an early date. In several cases, the hearing has been held on application for an order of sale. *Habirshaw Electric Cable Co. v. Habirshaw Electric Cable Co., Inc.*, 296 Fed. 875 (C. C. A. 2d, 1924); *Eastern States Public Service Corporation v. Atlantic Public Utilities*, 17 Del. Ch. 338, 156 Atl. 214 (1931); *Hauer v. Appalachian Gas Corporation*, 19 Del. Ch. 283, 167 Atl. 839 (1933); cf. *Clinton Trust Co. v. 142-144 Joralemon Street Corp.*, 237 App. Div. 789, 263 N. Y. Supp. 359 (2d Dep't, 1933).

37. *National Surety Co. v. Coriell*, 289 U. S. 426 (1933).

38. *Jennings v. Fidelity & Columbia Trust Co.*, 240 Ky. 24, 41 S. W. (2d) 537 (1931);

procedure employed is to procure the approval upon application by the receiver for permission to enter into the reorganization.<sup>39</sup> And in New York, the interesting practice was developed of considering the fairness of a plan for a voluntary reorganization proposed by a committee before granting the committee access to the list of bondholders.<sup>40</sup> In many of these cases, the court's jurisdiction has been attributed to its power to decide questions affecting the property in its possession.<sup>41</sup> This theory could be used even more effectively to support the power of the court to approve a plan for exemption purposes, for not only might the fairness of the plan have a possible effect on the property in custodia legis, but an exemption would reduce reorganization expenses. Other bases for jurisdiction have been suggested which likewise seem applicable where an exemption is sought, such as the duty of an equity court to see that its process is not employed to achieve unfair results; the power of the court to prevent the consummation of an unfair sale through the use of the bidding advantage possessed by a majority of the security holders; and the power of the court to administer the trust which is before it either as a result of the foreclosure of a mortgage deed of trust, or because of the trust relationship between a committee and its depositors.<sup>42</sup> Accordingly, it appears that a receivership court may have power to pass on the fairness of the plan even in the early stages of the proceedings, and even though no controversial issues are thereby decided.<sup>43</sup>

If the court has the requisite jurisdiction, a subsidiary problem may arise as to whether this jurisdiction can be invoked by advocates of a plan who are not original parties to the proceeding. In the event that it becomes necessary to obtain an exemption before the sale occurs, they must intervene in order to present their plan.<sup>44</sup> In the past, intervention in reorganization proceedings has

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see *Parker v. New England Oil Corporation*, 4 F. (2d) 392, 394 (D. Mass. 1924); *Moore v. Splittorf Electrical Co.*, 114 N. J. Eq. 358, 368, 168 Atl. 741, 745 (1933). *Contra*: *Platt v. Philadelphia & R. R. Co.*, 65 Fed. 872 (E. D. Pa. 1894). In *Bill v. New Albany, Etc. Ry. Co.*, 3 Fed. Cas. No. 1407, at 379 (D. Ind. 1870), it appears that a decree "ratifying and confirming" a voluntary reorganization agreement was obtained in a foreclosure action not involving a receivership.

39. *Jennings v. Fidelity & Columbia Trust Co.*, *Parker v. New England Oil Corporation*, both *supra* note 38.

40. *People v. S. W. Straus & Co.*, 149 Misc. 38, 267 N. Y. Supp. 227 (Sup. Ct. 1933); see Comment (1934) 34 COL. L. REV. 706, 727-730.

41. *Guaranty Trust Co. v. Missouri Pac. Ry. Co.*, 238 Fed. 812 (D. Mo. 1916); *Habirshaw Electric Cable Co. v. Habirshaw Electric Cable Co., Inc.*, 296 Fed. 875 (C. C. A. 2d, 1924); cf. *Graselli Chemical Co. v. Aetna Explosives Co.*, 252 Fed. 456 (C. C. A. 2d, 1918); see Comment (1934) 34 COL. L. REV. 706, 711.

42. See *Carey and Brabner-Smith*, *supra* note 9, at 11-14; *Fried*, *supra* note 4, at 315, n. 21.

43. See decree of the Delaware Court of Chancery, July 11, 1934, in the *Electric Public Service Company* receivership, noted in (1935) 1 CORP. REORG., at 234; cf. *Republic Supply Co. of California v. Richfield Oil Co. of California*, 74 F. (2d) 907 (C. C. A. 9th, 1935).

44. In certain cases, the approval need not precede promulgation of the plan, but is sufficient to afford exemption if obtained before the definitive securities are issued. See *supra*, note 10. In such cases, the purchasers at the sale could apparently submit their plan at the hearing for confirmation of the sale without intervention, since they become

sometimes been granted as a matter of right, sometimes in the court's discretion, and sometimes refused altogether, depending largely on the purpose of the intervention, and on whether the intervenor was already adequately represented in the proceedings.<sup>45</sup> Intervention for the purpose of presenting a plan for approval is a rather novel development. But the courts may regard it with greater favor than the more typical petition to come in for the purpose of attacking another's plan, since it does not seem to afford a weapon for obstructionists and strikers.<sup>46</sup> And conceivably a committee might be allowed to intervene for exemption purposes even though adequately represented in other matters by a trustee or receiver, on the theory that the ordinary duties of a trustee or receiver would not include obtaining judicial approval of a particular committee's reorganization plan.

On the question of a receivership court's power to pass on the fairness of a deposit agreement more difficulty is encountered. For not only is a controversy lacking, but there seems to be no body of precedent for such action.<sup>47</sup> Conceivably, the court's jurisdiction might be supported on the theory that the whole receivership constitutes a controversy, and that a decree approving a deposit agreement is merely the exercise of the court's power to administer the property in its possession.<sup>48</sup> For, as in the case of a reorganization plan, an exemption would reduce reorganization expenses.<sup>49</sup> Furthermore, it is arguable that the terms of a deposit agreement have a direct bearing on the merits of the reorganization plan which is ultimately developed, and hence affect the property before the court. Although it has been flatly denied that a deposit agreement has such an effect,<sup>49</sup> this attitude seems unrealistic, as has perhaps been recognized by one able judge, who suggested that intervention by a committee should always be conditioned on the court's approval of the committee's deposit agreement.<sup>50</sup> Again, if a deed of trust is involved, reliance might be placed on the court's power to administer the trust. In addition, the court's power might be said to exist on the theory that the deposit agreement itself constitutes a declara-

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parties through buying in at the sale. *Investment Registry v. Chicago & M. E. R. Co.*, 212 Fed. 594 (C. C. A. 7th, 1913).

45. See Moore and Levi, *Federal Intervention* (1936) 45 YALE L. J. 565, 595 et seq. There is some indication that the state courts are more liberal than the federal courts in this regard. See QUINDRY, op. cit. *supra* note 34, § 302. Statutes may be controlling in some jurisdictions. But even a mandatory statute has been construed as discretionary. *Meyer v. Title Guaranty & Trust Co.*, 228 App. Div. 641, 238 N. Y. Supp. 48 (2d Dep't, 1929); see Comment (1934) 34 COL. L. REV. 706, 715, n. 54.

46. Cf. Comment (1934) 34 COL. L. REV. 706, 715, n. 54; Comment (1934) 34 COL. L. REV. 1308, 1318.

47. Compare the attitude sometimes demonstrated with regard to bankruptcy proceedings. *Vitagraph v. St. Louis Prop. Corp.*, 77 F. (2d) 590 (C. C. A. 8th, 1935); see Comment (1936) 45 YALE L. J. 649, 654, n. 30.

48. See Legis. (1934) 34 COL. L. REV. 1348, 1354, n. 43.

49. *Habirshaw Electric Cable Co. v. Habirshaw Electric Cable Co., Inc.*, 296 Fed. 875 (C. C. A. 2d, 1924).

50. See statement by Judge Mack as Arbitrator in *Central Hanover Bank & Trust Co. v. Ulster & Delaware Railroad Co.*, S. D. N. Y. E., 61-329, April 8, 1932, set forth in ROHRLICH, op. cit. *supra* note 9, at 205, n. 36.

ion of trust. But even if the agreement could be classified as a trust instrument before deposits had been obtained, the proposition that a court has power to adjudicate upon the fairness of the terms of a trust instrument would be difficult to support. In case the requisite jurisdiction does exist, however, the subsidiary question again arises as to whether the committee can intervene to present its deposit agreement for approval and thus take advantage of the existing jurisdiction. In this connection, the problem is much the same as in the case of a reorganization plan. Some additional embarrassment might be experienced, in that the committee might be unable to show that it had an interest in the proceedings before it represented other security holders. Nevertheless, at least some members of the committee are sometimes security holders themselves,<sup>51</sup> and their interest might be sufficient to justify intervention. Whatever the theoretical considerations, however, courts have permitted intervention and issued orders approving deposit agreements apparently without serious question.<sup>52</sup>

If it is established that the necessary power of approval exists in receivership proceedings, it appears clear that the courts have power to provide for the requisite hearings. It has been a common practice to hold hearings on reorganization plans at which all interested parties were allowed to be heard.<sup>53</sup> The machinery employed has taken the form either of sending out individual notices to present objections<sup>54</sup> or of a widely published order to show cause.<sup>55</sup> There seems to be no reason why this practice could not be extended to include hearings concerning deposit agreements.

2. *Judicial Proceedings in Accordance with Special Statute.* The fundamental problem involved in considering the courts as possible sources of exemptions under Section 3 (a) (10) is not entirely solved by a statute conferring the necessary powers. For most constitutions would be violated by legislation attempting to foist administrative duties on constitutional courts.<sup>56</sup> But where the approval of reorganization plans and deposit agreements can be shown to be a proper judicial function,<sup>57</sup> a statutory provision authorizing such action

51. See ROHRlich, *op. cit. supra* note 9, at 72. It has been stated that the practice of including security holders as members of the committee is decreasing. See DEWING, *op. cit. supra* note 7, at 1108.

52. *MacManus v. The Celotex Company*, Eq. No. 981 (D. Del. 1934); see *Legis.* (1934) 34 COL. L. REV. 1348, 1353, n. 41.

53. See, e.g., *Jameson v. Guaranty Trust Co. of New York*, 20 F. (2d) 808, 815 (C. C. A. 7th, 1927).

54. See *Harding v. American Sumatra Tobacco Co.*, 14 F. (2d) 168, 169 (N. D. Ga. 1926); *Eastern States Public Service Corporation v. Atlantic Public Utilities*, 17 Del. Ch. 338, 156 Atl. 214 (1931).

55. *Jennings v. Fidelity & Columbia Trust Co.*, 240 Ky. 24, 41 S. W. (2d) 537 (1931). Notice by publication may be deemed insufficient by the Commission. As to the sufficiency of such notice to bind creditors, see Frank, *Some Realistic Reflections On Some Aspects of Corporate Reorganizations* (1933) 19 VA. L. REV. 698, 701-707.

56. Cf. *Muskrat v. United States*, 219 U. S. 346 (1911); *In re Richardson*, 247 N. Y. 401, 160 N. E. 655 (1928); see BORCHARD, *op. cit. supra* note 19, at 29-31.

57. For example, the constitutionality of empowering the bankruptcy courts by statute to exercise jurisdiction over deposit agreements has been defended on the ground that it is a power incident to the administration of the debtor's estate. See Gerdes, *The Consti-*

naturally removes all doubt as to the court's power to perform that function. Although several types of statutes containing provisions of this sort will be considered, their constitutionality depends on such varying factors that no attempt will be made here to include that question in the discussion.

Undoubtedly the most important type of statutory reorganization is that provided for by Section 77B of the Bankruptcy Act. In proceedings under that section, a much narrower problem is presented than in the case of an equity receivership. For here exemptions under Section 3 (a) (10) are necessary only in regard to certificates of deposit.<sup>52</sup> There is considerably more basis for arguing that a court supervising a reorganization under Section 77B has power to approve deposit agreements. For it has all the powers of a court of equity,<sup>53</sup> and in addition, is given authority under Section 77B (b) to scrutinize deposit agreements presented by creditors' committees.<sup>53</sup> Furthermore, Section 2 (15) of the Bankruptcy Act gives the court power to "make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this act."<sup>53</sup> It is arguable that the fundamental purpose of Section 77B is to facilitate reorganization and that, since consideration of a deposit agreement might be deemed to be one step in achieving that object, the court has power under Section 2 (15) to enter the necessary order.<sup>61</sup> The problem of intervention has been but little altered by the statute, but it seems clear that a committee representing a stockholder or bondholder would be allowed to intervene to present its agreement for approval in the court's discretion, under the provision that "any creditor or stockholder shall have the right to be heard . . . upon filing a petition for leave to intervene, on such . . . questions arising in the proceeding as the judge shall determine."<sup>62</sup> This provision would likewise authorize the court to afford the prospective recipients of certificates of deposit the necessary hearing if it saw fit. As in the case of equity receiverships, the courts have held hearings and entered orders approving deposit agreements, apparently without experiencing much doubt as to their jurisdiction.<sup>63</sup> Some of the agreements approved, however, have conferred but limited powers on the committee,<sup>64</sup> and the approval may be rendered only for the limited pur-

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*tutionality Of Section 77B Of The Bankruptcy Act* (1934) 12 N. Y. U. L. Q. REV. 196, 231-233; Weiner, *supra* note 8, at 1192.

58. § 77B (a). See GRANGE, *op. cit. supra* note 28, at 656-657.

59. The scrutiny power has usually been regarded as providing authority to afford exemptions for certificates of deposit under Section 3 (a) (10). See Dodd, *supra* note 4, at 1121-1122; Legis. (1934) 34 COL. L. REV. 1348, 1354. While the power is expressly granted only in respect to creditors' committees, it has apparently been exercised over agreements presented by stockholders' committees. See Rohrlich, *The New Deal In Corporation Law* (1935) 35 COL. L. REV. 1167, 1182.

60. 30 STAT. 545, 546 (1898), 11 U. S. C. A. § 11 (15) (1926).

61. Cf. *Continental Illinois Bank & Trust Co. of Chicago v. Chicago, R. I. & Pac. Ry.*, 294 U. S. 648 (1935).

62. § 77B (c) (10). See Moore & Levi, *supra* note 45, at 604.

63. *Matter of Paramount-Publix Corporation*, No. 56763 (S. D. N. Y., Feb. 20, 1935); see Legis. (1934) 34 COL. L. REV. 1348, 1353, notes 41, 42. But see *Matter of Prudence Bonds Corp.*, No. 26545 (E. D. N. Y., Sept. 14, 1934).

64. See Spaeth and Friedberg, *supra* note 11, at 146-148.

pose of providing exemptions, the court reserving jurisdiction to make such further orders as may prove necessary.<sup>65</sup>

In some instances, state statutes providing a general reorganization procedure appear to afford a source of power to grant exemptions under Section 3 (a) (10). For example, a Maine statute contains the broad provision that where a corporation is in statutory receivership, a reorganization may be conducted under the direction of the court, and such orders may be entered as equity requires.<sup>66</sup> Again, it is sometimes provided that if, while the corporation is in statutory receivership, a compromise between the corporation and its creditors, or stockholders, or both is proposed, the court shall order a meeting of the creditors, or stockholders, or both, and if the compromise agreement obtains sufficient support from these groups, it is to become binding with the approval of the court.<sup>67</sup> Likewise, several states allow a somewhat similar provision to be inserted in the corporate charter, and here the machinery may apparently be put in motion by a summary application to a court having equity jurisdiction, it being unnecessary that the corporation be in receivership.<sup>68</sup> Under all these statutes, it would appear to be within the court's power to hold the necessary hearings. Accordingly, these various provisions might be used as a basis for the requisite jurisdiction as to reorganization plans. But with the possible exception of the Maine statute, they would hardly prove of assistance in regard to deposit agreements. Several states have general provisions for reorganizations which do not appear to vest the court with any additional powers even in connection with the plan.<sup>69</sup>

The recent deflation of real estate values has led in a few instances to more specialized legislation designed to facilitate real estate mortgage reorganizations. One type of such legislation places the problem of rehabilitating mortgage

65. This was done in *Matter of Paramount-Publix Corporation*, No. 56763 (S. D. N. Y., Feb. 20, 1935).

66. ME. REV. STAT. (1930) c. 56, §§ 87, 88; cf. N. Y. STOCK CORP. LAW (1901) § 20 (1897), §§ 22, 106 (1922); S. D. COMP. LAWS (1929) §§ 8825-8829.

67. ILL. REV. STAT. (1935) c. 32, § 90 (c); PA. STAT. (Purdon, 1936) tit. 15, § 2852-1109 (3); MINN. STAT. (Mason's Supp. 1934) § 7492-54; WASH. REV. STAT. ANN. (Remington's Supp. 1935) § 3803-58. Kentucky has a somewhat similar provision applicable only to railroad and bridge companies. KY. STAT. (Carroll 1930) § 771a (1-6). The Minnesota statute may be made inapplicable by a charter provision to that effect. For discussions of this type of statute, see Hoshour, *The Minnesota Business Corporation Act* (1933) 18 MINN. L. REV. 1, 12; Little, *The Illinois Business Corporation Law* (1934) 28 ILL. L. REV. 997, 1019, 1020.

68. COLO. COMP. STAT. (Supp. 1932) § 2243 (8); DEL. REV. CODE (1915) c. 65, § 5, as amended by Laws 1927, c. 85; Mich. Acts 1935, No. 194, § 4 (3); W. VA. CODE (1931) c. 31, art. 1, § 6 (h). Louisiana has a similar statute applicable only if the corporation is in statutory receivership. LA. GEN. STAT. (Dart, 1932) § 1143. For discussions of this type of statute, see Sargent and Zerkowich, *The Problem of Reorganizing "Solvent" Corporations* (1934) 29 ILL. L. REV. 137, 142; Comment (1932) 30 MICH. L. REV. 934. Although these provisions have been inserted in charters, they have apparently not been used as a method of reorganization. See GLENN, *op. cit. supra* note 8, § 428.

69. See, e.g., N. Y. STOCK CORP. LAW (1923) §§ 95-99; OHIO GEN. CODE (Page's Supp. 1926-1935) § 8623-15a; PA. STAT. (Purdon, 1936) tit. 15, §§ 2852-311, 2852-312; WIS. STAT. (1931) § 181.05.

guaranty companies in the hands of an administrative agency under court supervision. Statutes of this sort exist in California, New Jersey and New York, the latter state having two statutes—the Schackno Act and the Mortgage Commission Act.<sup>70</sup> The statutes in all three states give the court express power to hold hearings and pass on the fairness of reorganization plans, the California Act adopting almost the same wording as is employed in Section 3 (a) (10). Accordingly, an exemption for definitive securities issued in these reorganizations<sup>71</sup> may be available if the approval can be granted before registration becomes necessary. The California statute clearly allows the court to approve the plan before it is promulgated,<sup>72</sup> and nothing in the New Jersey statute appears to prevent such action. But both New York acts contemplate the submission of the plan to the security holders before judicial approval. Inasmuch as the approval must sometimes precede the promulgation of the plan in order to gain exemption,<sup>73</sup> the availability of an exemption may depend on the court's jurisdiction aside from express statutory authorization. None of the three statutes provide explicitly for court approval of deposit agreements. Accordingly, where this approval becomes necessary,<sup>74</sup> recourse would have to be had to a general grant of power,<sup>74</sup> or to the inherent jurisdiction of the court. The New Jersey court has entered an order approving a deposit agreement in a proceeding under the statute.<sup>75</sup>

In New York and Michigan, a second type of statute exists which is designed to protect bondholders in a foreclosure action.<sup>76</sup> Both statutes give the trustee

70. Cal. Laws 1935, c. 145, § 12629; N. J. Laws 1934, c. 3, as amended by c. 64; N. Y. Laws 1933, c. 745, as amended by Laws 1935, c. 588, Laws 1934, c. 919, Laws 1933, c. 780 (Schackno Act); N. Y. Laws 1935, c. 19, as amended by c. 290, c. 586, c. 638 (Mortgage Commission Act). For discussions of this type of legislation, see Comment (1934) 34 COL. L. REV. 663; Note (1934) 43 YALE L. J. 1007; Comment (1935) 35 COL. L. REV. 874. The California statute is to expire April 1, 1937, or earlier, if the insurance commissioner finds the emergency is terminated. The Schackno Act is to expire in 1940.

71. The issue of new definitive securities is not always necessary in these reorganizations where there is no foreclosure sale. See Fried, *supra* note 4, at 317.

72. A certain percentage of the security holders must consent to the plan, but consents are expressly made effective whether obtained before or after court approval of the plan.

73. Protective committees would probably be little used under the California statute, since they could not propose a reorganization plan, that function being delegated exclusively to the Commission or the mortgage insurer. Cal. Laws 1935, c. 145, § 12629 (c). And committees are not absolutely necessary under any of the acts, since the administrative body might propose and carry out the plan without any centralization of the security holders' interests. In New York, provision has been made for the formation of corporations to perform the functions of protective committees, but the courts are given no special supervision over these corporations. N. Y. Laws 1933, c. 453.

74. The New Jersey statute contains a very broad general grant of power. N. J. Laws 1934, c. 3, § 6. The New York Mortgage Commission Act authorizes the court to "make orders in respect of any and all matters as to which court action is hereby provided" and to make orders "to enforce any provision of this act." N. Y. Laws 1935, c. 19, § 17. The California court may "determine all questions required to be determined pursuant to this section." Cal. Laws 1935, c. 145, § 12629 (d).

75. In *The Matter Of Fidelity Union Title And Mortgage Guaranty Company*, No. 99/590 (N. J. Ch., Feb. 21, 1934).

76. MICH. COMP. LAWS (Mason, Supp. 1933) § 14380 (1-9); N. Y. REAL PROPERTY LAW (1933) §§ 119-123.

of the mortgage deed power to buy in at the foreclosure sale, and the New York act confers authority upon the court to pass upon the fairness of reorganization plans. The Michigan statute does not grant this power in express terms, but it might perhaps be implied from the rather broad control the court is given over the trustee, particularly in the section of the act empowering the court to approve the terms and conditions of any sale by the trustee.<sup>77</sup> In neither statute is there express authority to approve deposit agreements. In Michigan, however, a protective committee could obtain the necessary supervision elsewhere, and a court approval of its deposit agreement would seem unnecessary.<sup>78</sup> Both statutes provide adequately for notice and hearings.

Another specialized type of legislation in several states gives the courts jurisdiction over the reorganization of state banks.<sup>79</sup> But the statutory provisions will rarely prove useful in regard to exemptions under Section 3 (a) (10). For while the courts are frequently expressly authorized to afford the necessary hearings and approvals in connection with reorganization plans, it would usually be unnecessary to obtain exemptions under Section 3 (a) (10) for definitive securities issued by the new or reorganized bank.<sup>80</sup> And no express provisions exist authorizing the approval of deposit agreements. A more noteworthy statute, however, has recently been enacted in New York concerning the resumption of business by a state bank which has been in the possession of the bank superintendent.<sup>81</sup> It provides that such a bank, upon re-opening, is to issue to its depositors non-negotiable transferable certificates representing the portion of their accounts not subject to withdrawal. It further provides that the holders of certificates representing at least 15% of the principal amount may form a corporation for the purpose of issuing its securities in exchange for the certificates. Upon the request of the certificate holders, and the consent of the superintendent of banks, the bank may apply to a court for an order approving the terms and conditions of the proposed exchange. In words seemingly looking to an exemption under Section 3 (a) (10), provision is then made for the necessary notice, hearing, and approval of the exchange. This clearly affords an opportunity for exemption of the definitive securities issued by the new corporation. But there is no express provision for the approval of deposit agreements, in case they should become necessary in centralizing the interests of the certificate holders.

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77. MICH. COMP. LAWS (Mason, Supp. 1933) § 14380-8.

78. See *infra*.

79. IOWA CODE (1935) § 9239-a (1-5); MICH. COMP. LAWS (Mason, Supp. 1933) § 11962-1; MISS. CODE ANN. (Supp. 1933) § 3817-1; NEV. STAT. 1933, c. 190, §§ 68-75; N. H. PUB. LAWS (1926) c. 263; N. Y. BANKING LAW (1933) § 61-a; N. D. LAWS 1933, c. 72; OHIO LAWS 1935, pp. 34-36; S. C. CODE (Supp. 1934) § 7856; TEX. ANN. CIV. STAT. (Vernon, 1925) art. 454; VT. PUB. LAWS (1933) §§ 6761-6770.

80. Section 3 (a) (2) of the Securities Act exempts "any security issued or guaranteed by any national bank or by any banking institution organized under the laws of any State or Territory or the District of Columbia the business of which is substantially confined to banking and is supervised by the State or territorial banking commissioner or similar official;" The phrase "substantially confined to banking" may make the exemption inapplicable to some trust companies. See Feldman, *The New Federal Securities Act* (1934) 14 B. U. L. REV. 1, 25.

81. N. Y. LAWS 1935, c. 553.

3. *No Proceedings Pending.* Perhaps the most serious difficulties in obtaining exemptions from the courts under Section 3 (a) (10) are presented where the exchange of securities, or the solicitation thereof, transpires at a time when no court proceedings are in progress. The problem sometimes arises in regard to definitive securities, as in the case of a statutory merger or consolidation, a stockholders' sale of the corporate assets, an exchange of new stock for existing shares of the same corporation, a voluntary scaling down of the corporate debt structure, or a sale of the corporate assets following a foreclosure by entry or under a power of sale provided for in a mortgage or deed of trust. Or it may occur in connection with certificates of deposit, where it is necessary to solicit deposits in any of the foregoing situations, or before the commencement of proceedings in equity receivership or under Section 77B. Under such conditions, a declaratory judgment statute appears to offer the only conceivable method of obtaining a court hearing.<sup>82</sup> But the same fundamental obstacles are encountered in obtaining declaratory relief as in any other judicial proceeding. For the only distinctive feature of the declaratory judgment statutes is that they authorize a declaration concerning legal relations without the necessity of appending some form of coercive execution. By no means do they obviate the requirements that there be the usual operative facts creating a right, privilege or immunity; that there be an actual, and not merely fictitious controversy between adverse parties; and that the court have jurisdiction over the subject matter and parties.<sup>83</sup> Indeed, the need of an actual controversy over the fairness of the reorganization plan or deposit agreement is accentuated in a declaratory proceeding. For the court's jurisdiction could not be based on its powers incidental to the administration of an estate, as in proceedings in receivership, or under Section 77B.

The lack of a controversy between adverse parties appears to present an insurmountable difficulty in the case of certificates of deposit and of definitive securities exchanged in pursuance of a voluntary scaling down of the corporate debt structure. If the issue raised were simply whether the Securities Act applied to the securities in question, an action by the issuer against the Commission or the Attorney General seeking a declaration of exemption might well present a sufficient controversy to justify declaratory relief.<sup>84</sup> But here the operative fact giving rise to the complainant's claim of exemption is the declaration of approval itself. Before that approval has been obtained, a prospective issuer would appear to have no basis for a claim of exemption as against the administrators of the Act. Rather, he must bring his proceeding against someone legally interested in contesting the fairness of his plan or agreement. On this issue, those entrusted

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82. The United States and many states have declaratory judgment statutes. For a compilation, see BORCHARD, *op. cit. supra* note 19, at 634-650.

83. See BORCHARD, *op. cit. supra* note 19, at 23, 24.

84. Cf. *American Trust Co. v. McAllister*, 136 Ore. 338, 299 Pac. 319 (1931); *In re Petition of Templar Motor Car Company*, 27 Dauphin County 276 (Pa. C. P. 1924); *Stuart v. Utility Investing Corporation*, 78 F. (2d) 279 (C. C. A. 3d, 1935) (bill for injunction). A proceeding has been brought to obtain a declaration of exemption under Section 3 (a) (9) of the Securities Act. See S. E. C. Release No. 646 (Class C) Feb. 3, 1936, 133 C. C. H. § 2161.05.

with the enforcement of the Act could hardly be said to have an adverse interest. And, as previously pointed out, no controversy between adverse parties would appear to exist between the issuer and the prospective recipients of securities under the deposit agreement or the plan of voluntary reorganization.<sup>85</sup>

In the case of a stockholders' sale of assets, a merger or consolidation, or an exchange of new stock for existing shares of the same corporation, however, a better opportunity for obtaining declaratory relief would seem to be presented. Conceivably, a corporation intent upon carrying out such a reorganization might institute proceedings making several stockholders defendants as representatives of any who might wish to join them.<sup>86</sup> As previously indicated, such an action might well involve a controversy over the fairness of the reorganization plan,<sup>87</sup> and therefore warrant a declaratory judgment. Of course, some actual opposition would be necessary, since courts will refuse declaratory relief where the controversy before them is obviously fictitious.<sup>88</sup> But if a justiciable controversy can be shown, the path to declaratory relief in the state courts should be fairly clear. Additional jurisdictional questions would arise, however, in the federal courts. The requirement as to jurisdictional amount could probably be easily satisfied, since the value of the property in question would in all likelihood exceed \$3,000. But it would also be necessary to show diversity of citizenship.<sup>89</sup> The requisite diversity would exist if all the representative defendants were citizens of states other than that of incorporation of the plaintiff. And this would be true although other stockholders whom they represented were citizens of the state of incorporation.<sup>90</sup> Nor would the court be ousted of jurisdiction if some of the latter stockholders intervened to be heard in the proceedings.<sup>91</sup> The problem of obtaining diversity as to the representative defendants, however, is complicated by the possibility that a proceeding of this nature, involving the internal affairs of the corporation, might be allowed only in the state of incorporation.<sup>92</sup> If the corporation were thus forced to bring its proceeding in the

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85. See *supra*, p. 1055; Legis. (1934) 34 COL. L. REV. 1348, 1353.

86. A somewhat analogous situation was presented in *Lake St. El. R. Co. v. Ziegler*, 99 Fed. 114 (C. C. A. 7th, 1900), where a corporation brought suit against individual minority bondholders, seeking to have the court approve a voluntary reorganization plan and enjoin the defendants from foreclosing. For a discussion of the problems involved in suing representative defendants, see Comment (1922) 36 HARV. L. REV. 89. There should be no unusual difficulty in bringing declaratory proceedings against representative defendants. Such action has been adopted in suits against taxpayers. *City of Muskegon Heights v. Denigelis*, 253 Mich. 260, 235 N. W. 83 (1931); see Ellingwood, *Declaratory Judgments In Public Law* (1934) 29 ILL. L. REV. 174, 183.

87. See notes 22, 23, 24, *supra*.

88. See Ellingwood, *Declaratory Judgments In Public Law* (1934) 29 ILL. L. REV. 1, 28-30.

89. For a discussion of the questions relating to federal jurisdiction under the Federal Declaratory Judgment Act, see (1935) 13 N. C. L. REV. 324.

90. *Supreme Tribe of Ben-Hur v. Cauble*, 255 U. S. 356 (1921).

91. *Stewart v. Dunham*, 115 U. S. 61 (1885); see *Supreme Tribe of Ben-Hur v. Cauble*, 255 U. S. 356, 366 (1921).

92. Cf. *Wallace v. Motor Products Corporation*, 25 F. (2d) 655 (C. C. A. 6th, 1928). This limitation on jurisdiction is usually based on grounds of public policy and is by no means universally applied. See *Robrlich, supra* note 23, at 722, 723. Moreover, the rule

state of incorporation, it might prove difficult to obtain personal service on any stockholders who were citizens of other states. Of course, stockholders of foreign citizenship might be present in the state of incorporation, or perhaps their consent or appearance could be procured. The latter course, however, might possibly be regarded by the court as indicative of collusion, and hence prove fatal.<sup>93</sup> If these difficulties can be overcome, no reason appears why a federal court could not enter a declaration approving a reorganization plan of the type under discussion. In proceedings of this nature either the federal or state courts could allow all interested parties to be heard as freely as in other cases.<sup>94</sup>

There is perhaps a slight possibility that a similar device could be employed in the case of a reorganization following a foreclosure by entry or under a power of sale provided for in a mortgage or deed of trust. For example, a bondholders' committee might institute the proceedings, naming dissenting bondholders or bondholders of another class as representative defendants. The lack of decisions involving a dispute over the fairness of the reorganization in such circumstances, however, would undoubtedly prove a serious handicap in showing that there existed any controversy over which the court had power to adjudicate. If the need for exemption were urgent, it would perhaps be more advisable to commence judicial foreclosure proceedings and attempt to obtain the court's approval of the plan during the foreclosure action, rather than to proceed under the power of sale.<sup>95</sup>

A final factor that should be taken into consideration in regard to obtaining declaratory relief is that the court's action is often deemed to be discretionary,<sup>96</sup> and hence peculiarly open to guidance by the dictates of public policy. Courts may feel that the purpose of Section 3 (a) (10) was merely to avoid the duplication of functions which would result if registration were required where a court already had a reorganization under supervision, supposedly providing adequate protection to those interested, and that an adjudication designed only to avoid registration would not accord with the policy of the Securities Act.<sup>97</sup> Furthermore, a court might be averse to undertaking the burdensome task of examining an entire reorganization scheme until absolutely necessary. It might well be considered socially desirable, however, regardless of the question of

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is ordinarily invoked in suits against the corporation, and might not be enforced where the corporation itself sues in a foreign state.

93. The defendants must fairly represent those whose rights are involved, so that the issues may be fully and honestly tried. See *Smith v. Swormstedt*, 16 How. 288, 303 (U. S. 1853); *Farmers Loan and Trust Co. v. Lake St. El. R. R. Co.*, 68 Ill. App. 666, 681 (1896).

94. Parties represented are ordinarily allowed to intervene and be heard at any stage of a class suit. See *Wheaton, Representative Suits Involving Numerous Litigants* (1934) 19 CORN. L. Q. 399, 422; Comment (1934) 34 COL. L. REV. 118, 128.

95. A power of sale contained in a mortgage is usually regarded as a cumulative remedy not affecting the right to foreclose in equity. 3 JONES, MORTGAGES (1928) § 2295. There is perhaps more question as to the right to foreclosure of a trust deed, but such an action might be entertained on the theory that the court was administering the trust. See *Carey, Brabner-Smith and Sullivan, Studies In Foreclosures In Cook County* (1933) 27 ILL. L. REV. 595, 620.

96. See *BOESCHARD*, op. cit. *supra* note 19, at 99-113; *Ellingwood*, *supra* note 86, at 213, 214.

97. Cf. *Hayden Plan Co. v. Friedlander*, 97 Cal. App. 12, 275 Pac. 253 (1929).

exemptions under Section 3 (a) (10), that such an examination be had for the purpose of protecting the security holders involved.<sup>98</sup>

#### ADMINISTRATIVE BODIES

A number of federal administrative bodies appear to have sufficient authority to afford exemptions under Section 3 (a) (10),<sup>99</sup> but their jurisdiction is restricted to specialized types of reorganizations, and in some cases would not be invoked because of the availability of other exemptions. For example, the Interstate Commerce Commission might well have the requisite power in regard to securities issued during railroad reorganizations.<sup>100</sup> But such reorganizations would ordinarily be conducted under Section 77 of the Bankruptcy Act, which itself affords exemptions for both definitive securities and certificates of deposit,<sup>12</sup> and definitive securities issued by a carrier subject to the Transportation Act are exempt under Section 3 (a) (6) of the Securities Act. Again, several federal bodies possess powers of supervision over the various federal financial institutions. Thus, the Comptroller of the Currency is expressly authorized to pass upon the fairness of plans for the reorganization of national banks,<sup>101</sup> and is given rather broad power to supervise national agricultural credit corporations;<sup>102</sup> the Farm Credit Administration is given control over receivership proceedings involving federal land banks, joint stock land banks, national farm loan associations, and federal intermediate credit banks;<sup>103</sup> the Governor of the Farm Credit Administration may prescribe rules and regulations for the merger, consolidation or dissolution of federal credit unions;<sup>104</sup> and the Federal Reserve Board is authorized to supervise generally, and to liquidate or reorganize federal reserve banks.<sup>105</sup> These various agencies might well have sufficient authority to afford exemptions under Section 3 (a) (10) for definitive securities issued by the particular institution involved.<sup>106</sup> But such exemptions would be unnecessary where the

98. See Comment (1935) 45 YALE L. J. 105, 119, 120.

99. It was contemplated that such federal agencies as the Farm Credit Administration, the Federal Reserve Board, and the Comptroller of the Currency would perform this function. Statement of House Conference Managers (1934) 78 CONG. REC. 10264.

100. The Commission may hold hearings and render approval in connection with the issuance of securities by an interstate carrier. 41 STAT. 494-497 (1920), 49 U. S. C. A. § 20a (1926). And it is given power to pass on reorganization plans and deposit agreements in proceedings under Section 77 of the Bankruptcy Act. § 77 (d) (p).

101. 48 STAT. 3, 72 (1933), 12 U. S. C. A. § 207 (1935).

102. "All National Agricultural Credit Corporations shall be under the supervision of the Comptroller of the Currency. . . . The Comptroller of the Currency shall exercise the same general power of supervision over such corporations as he exercises over national banks. . . ." 42 STAT. 1467 (1923), 12 U. S. C. A. § 1241 (1926).

103. 39 STAT. 381 (1916), 42 STAT. 1454 (1923), Ex. Or. 6084, March 27, 1933, 12 U. S. C. A. §§ 961, 963, 1025 (1935).

104. 48 STAT. 1221 (1934), 12 U. S. C. A. § 1766 (a) (1935).

105. 38 STAT. 262 (1913), 12 U. S. C. A. § 248 (h) (j) (1926). These powers are not impaired by the Bank Conservation Act. 48 STAT. 5 (1933), 12 U. S. C. A. § 210 (1935).

106. A letter from general counsel of the Farm Credit Administration contains the following statement concerning joint stock land bank receiverships: "In connection with receivership plans for the purchase and liquidation of assets, securities may be issued in exchange for the claims of bondholders against the trust assets. On June 27, 1934 it was

securities could be brought within Section 3 (a) (2) of the Securities Act.<sup>107</sup> And it appears doubtful whether the powers conferred on the administrative officials and bodies mentioned are sufficiently broad to justify granting exemptions for certificates of deposit issued by independently organized protective committees. The federal bodies presenting the most far-reaching possibilities as sources of exemptions are perhaps the Securities and Exchange Commission itself and the Federal Power Commission. It seems clear that the Public Utility Holding Company Act gives the Securities and Exchange Commission authority to hold hearings and to pass upon the fairness of plans for the reorganization of public utility holding companies,<sup>108</sup> and it is barely possible that the Commission has similar powers in regard to the issuance of certificates of deposit during such reorganizations.<sup>109</sup> It is perhaps more doubtful whether these powers may be exercised to afford exemptions under Section 3 (a) (10), since the Holding Company Act provides that nothing contained in it is to "affect the rights, obligations, duties, or liabilities of any person" under the Securities Act.<sup>110</sup> It is arguable, however, that the object of this provision was merely to make it clear that the

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ruled by the Federal Trade Commission, [then administering the Securities Act] that if such securities are issued pursuant to section 3 (a) (10) 'and the terms and conditions of their issuance have been approved, after the required hearing, by the Farm Credit Administration, they are exempt from all provisions of the Securities Act except those contained in Sections 12 (2), 17 and 24.' Similar rulings would presumably follow in regard to federal land banks, national farm loan associations, or federal intermediate credit banks.

107. That section exempts "Any security issued or guaranteed by the United States or any Territory thereof . . . or by any person controlled or supervised by and acting as an instrumentality of the government of the United States pursuant to authority granted by the Congress of the United States, or any certificate of deposit of the foregoing, or any security issued or guaranteed by any national bank . . . or any security issued by or representing an interest in or a direct obligation of a Federal Reserve Bank."

108. A registered holding company must file a declaration with the Commission before issuing securities or altering the rights of security holders. 49 STAT. 814, 15 U. S. C. A. § 79 f (1935). The Commission is authorized to hold hearings and to decide whether the terms and conditions of the issuance of the securities, or the proposed alteration of security holders' rights is detrimental to the interest of the public, investors, or consumers, in determining whether the declaration is to become effective. 49 STAT. 815, 15 U. S. C. A. § 79 g (1935).

Likewise, in any proceeding in a federal court for the reorganization of a registered holding company, the reorganization plan is not to become effective unless approved by the Commission, after hearing, prior to its submission to the court. 49 STAT. 820, 15 U. S. C. A. § 79 k (f) (1935).

The Commission has adequate power to hold hearings and admit all interested persons as parties. 49 STAT. 832, 15 U. S. C. A. § 79 s (1935). For a discussion of these powers by the Commission's general counsel, see S. E. C. Release No. 54 (Public Utility Holding Company Act series), Dec. 23, 1935, 133 C. C. H. § 8510.

109. No deposits in connection with a reorganization plan may be solicited until the plan has been approved by the Commission. And the Commission may issue such rules, regulations, or orders regarding such solicitation as it deems necessary or appropriate in the public interest, or for the protection of investors or consumers. 49 STAT. 820, 15 U. S. C. A. § 79 k (g) (1935). See S. E. C. Release No. 54 (Public Utility Holding Company Act series), Dec. 23, 1935, 133 C. C. H. § 8510.

110. 49 STAT. 834, 15 U. S. C. A. § 79 u (1935).

terms of the Holding Company Act do not of themselves repeal or modify the Securities Act and that the provision was not intended to negative a grant of authority to the Commission to afford exemptions contemplated in the Securities Act. The Federal Power Act provides that no electric utility subject to the Act can dispose of its assets, merge, or consolidate without the approval of the Federal Power Commission, and likewise authorizes the latter body to pass upon all issues of securities by electric utilities subject to the Act.<sup>111</sup> This authority appears sufficient to justify exemptions under Section 3 (a) (10) for definitive securities issued in reorganizations, but hardly seems broad enough to apply to certificates of deposit.<sup>112</sup> No other federal administrative bodies appear to have the necessary jurisdiction. The Reconstruction Finance Corporation is empowered to make loans subject to such terms, conditions, and restrictions as its directors determine; and it may compromise claims against a railroad in reorganization under Section 77 or in equity receivership by taking securities on terms to be approved by the Corporation.<sup>113</sup> Likewise, the Secretary of the Treasury is authorized by Section 77B (e) of the Bankruptcy Act to consent to a reorganization plan in proceedings under that section where the United States is a creditor or stockholder. But these powers could hardly be stretched sufficiently to justify holding hearings and passing upon the fairness of the plan or agreement involved with regard to other interested parties.<sup>114</sup>

Several types of state administrative bodies merit consideration as possible sources of exemptions under Section 3 (a) (10). Of these, banking and insurance commissioners are specifically mentioned in the section itself. The question as to the power of these officials to afford exemptions for reorganization issues by banks and insurance companies is relatively unimportant, since definitive securities issued by a new or reorganized bank would ordinarily be exempt under Section 3 (a) (2) of the Securities Act,<sup>80</sup> and insurance companies are usually liquidated rather than reorganized.<sup>115</sup> Where the problem does arise, however, it is complicated by the uncertainty as to whether these officials must be expressly authorized to afford the necessary hearings and approvals.<sup>110</sup> The

111. P. L. No. 333, 74th Cong., 1st Sess. (1935) tit. II, §§ 203, 204.

112. The original House amendment exempted securities issued under the supervision of the Federal Power Commission from the Securities Act. But the following provision was substituted in conference: "Any public utility whose security issues are approved by the Commission . . . may file with the Securities and Exchange Commission duplicate copies of reports filed with the Federal Power Commission in lieu of the reports, information, and documents required under section 7 of the Securities Act. . . ." P. L. No. 333, 74th Cong., 1st Sess. (1935) tit. II, § 204 (h). See Statement of House Conference Managers (1935) 79 CONG. REC. 14621. This might be considered as indicating Congress' belief that supervision by the Power Commission would not be an adequate substitute for the sanctions of the Securities Act.

113. 48 STAT. 1108, 1109 (1934), 49 STAT. 4, 15 U. S. C. A. § 606 (b) (g) (1935).

114. For a discussion of the function of the Secretary of the Treasury in reorganizations, see (1935) 1 CORP. REORG. 383. The Reconstruction Finance Corporation is apparently making some constructive suggestions in reorganizations in which it is involved. See (1934) 1 CORP. REORG. 143.

115. See Legis. (1933) 33 COL. L. REV. 722.

116. The wording of Section 3 (a) (10), set forth *supra*, note 5, seems ambiguous in

power to approve reorganization plans is sometimes given to bank commissioners,<sup>117</sup> and in lesser degree, to insurance commissioners.<sup>118</sup> But there is seldom any express provision for hearings at which prospective recipients of securities can be heard,<sup>119</sup> and in some cases the officials are not authorized to pass upon the fairness of the plan.<sup>120</sup> Nowhere is there express authorization to pass upon deposit agreements.<sup>121</sup> Accordingly, if the power of these officials to fulfill the requirements of Section 3 (a) (10) exists at all, it must ordinarily be implied, and hence, in most cases, they could afford exemptions only if the section should be interpreted as not requiring express statutory authorization.

In connection with the remaining state bodies, the requirements of Section 3 (a) (10) undoubtedly are satisfied only if there exists a clear statutory authoriza-

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this connection, in view of the lack of punctuation following "banking or insurance commission." Cf. Op. of Gen'l Counsel, *supra* note 13.

117. See discussion and compilation of statutes in Merry, *Bank Reorganization and Recapitalization In Michigan* (1933) 32 MICH. L. REV. 137; Legis. (1932) 32 COL. L. REV. 1395; Legis. (1934) 34 COL. L. REV. 152; Comment (1933) 32 MICH. L. REV. 221; Note (1933) 43 YALE L. J. 346.

118. There are very few statutes providing for general reorganization of insurance companies, the typical legislation being designed to effectuate liquidation. See Legis. (1933) 33 COL. L. REV. 722; Comment (1934) 43 YALE L. J. 1146. There are, however, a few rehabilitation statutes which give the commissioner some degree of control over the disposition of the property. Ind. Acts 1935, c. 162, art. II; MD. ANN. CODE (Flack, Supp. 1935) art. 48A, §§ 51-51M; MO. STAT. ANN. (Vernon, Supp. 1935) v. 6, § 5950; N. Y. INS. LAW (1933) art. XI, §§ 400-428.

It is rather commonly provided that merger or consolidation must have the approval of the commissioner. ARK. DIG. STAT. (Crawf. & Moses, Supp. 1927) § 5975c; GA. CODE (1933) § 56-1618; ILL. REV. STAT. (1935) c. 731, §§ 29-31; Ind. Acts 1935, c. 162, §§ 114-119; IOWA CODE (1935) §§ 9105-9117; KAN. REV. STAT. ANN. (Supp. 1933) § 40-309; MD. CODE (Bagby, 1925) art. 48A, § 48; MASS. GEN. LAWS (1932) c. 175, § 19A; N. J. COMP. STAT. (1911) p. 2853, § 48; N. C. CODE (1935) § 217 (n); OHIO GEN. CODE (Page, 1926) § 9351; OKLA. STAT. ANN. (Harlow, 1931) §§ 10791-10801; PA. STAT. (Purdon, 1936) tit. 40, §§ 456, 459a; S. D. COMP. LAWS (1929) §§ 9165-9167; TEX. ANN. CIV. STAT. (Vernon, 1925) art. 5041; WASH. REV. STAT. ANN. (Remington, 1932) § 1060; WIS. STAT. (1933) § 201.30.

The statutes cited in note 70, *supra*, relating to the reorganization of mortgage guaranty companies, contemplate that the commission or commissioner is to approve reorganization plans.

In a few states the commissioner is given control over the issuance of securities by an insurance company. Cal. Laws 1935, c. 145, §§ 820-860; KAN. REV. STAT. ANN. (Supp. 1933) § 40-104; OHIO GEN. CODE (Page, 1926) § 6373-19.

119. This is typically true of the provisions relating to banks. See Legis. (1934) 34 COL. L. REV. 152, 153. Occasionally hearings are provided for regarding the merger or consolidation of insurance companies. See statutes of Indiana, Iowa, and South Dakota, *supra*, note 118. The administrators of the statutes relating to mortgage guaranty companies, cited *supra*, note 70, are not expressly authorized to hold hearings.

120. This is particularly true of the statutes relating to the merger or consolidation of insurance companies, cited *supra*, note 118.

121. A New York statute provides for the formation of corporations to perform the function of protective committees. See *supra*, note 73. The insurance commissioner is empowered to approve or disapprove of the certificate of incorporation of such bodies, but presumably the terms and conditions of the proposed exchange of securities would not appear in the certificate.

tion to hold hearings at which all prospective recipients of securities have the right to be heard, and to approve the fairness of the terms and conditions of exchange.<sup>123</sup>

One potential source of exemptions lies in the state security commissions. But an examination of the various blue sky laws<sup>122</sup> leads to the conclusion that very few commissions have the requisite authority. Two types of statutes must be eliminated at the outset as offering no possibilities, namely, those which become operative only when evidence is presented that fraud has been or is about to be committed,<sup>123</sup> and those which merely require that dealers be licensed.<sup>124</sup> In the case of the remaining statutes, which require a permit for each issue of securities, various difficulties arise. In the first place, securities issued in reorganizations may be unaffected by the statute. It is true that definitive securities issued pursuant to a reorganization would, in most cases, come within the definition of "security" used in the particular act. It would sometimes be more doubtful whether certificates of deposit were also included.<sup>125</sup> But an apparently insuperable obstacle results in many cases from the fact that securities issued in the course of a "bona fide" reorganization are exempt.<sup>126</sup> And the administrators are seldom expressly given power to pass on the fairness of the terms and conditions of exchange. More often they are required to determine whether the sale of securities would work a fraud on the purchaser, or whether a "proposed plan of business" is fair. Perhaps the most serious difficulty, however, lies in the lack of satisfactory provisions for hearings. Some statutes merely require the filing of information, while others couple this with a discretionary power of investigation in the commission. In neither case does there seem to be a clear authorization to hold hearings. And even where hearings are authorized, it is seldom expressly provided that persons other than the applicant for the permit are to be heard. But in California, and perhaps Wisconsin, the statutes do vest their administrators with sufficient power. The California Securities Act has been amended with the express purpose of authorizing the Division of Corporations to hold the necessary hearings and grant the required approval, both as to reorganization plans and deposit agreements.<sup>127</sup> The Division has apparently been quite active in performing this function.<sup>128</sup> The Wisconsin statute, although not directed at Section 3 (a) (10), likewise appears to grant the requisite authority.<sup>129</sup> But its exercise is conditional upon a prelim-

122. For compilations of the state laws, see THORPE AND ELLIS, *FEDERAL SECURITIES ACT MANUAL* (1933) § 147; *CORPORATION MANUAL* (37th ed. 1936) p. 2021 et seq.; 132 C. C. H. pp. 5503-5984.

123. The statutes in Delaware, Maryland, New Jersey and New York are of this type.

124. Statutes of this type exist in Maine, Montana, New Hampshire, Pennsylvania and Rhode Island. The Connecticut statute requires permits for individual issues only in the case of mining and oil stocks.

125. See Comment (1933) 27 ILL. L. REV. 531, discussing the effect of the Illinois Securities Act on reorganizations.

126. See 132 C. C. H., Chart IV.

127. Cal. Laws 1935, c. 166. For discussions, see Comment (1935) 23 CALIF. L. REV. 348; Legis. (1935) 24 CALIF. L. REV. 107.

128. Information based upon a communication of April 6, 1936, from the California Division of Corporations to the YALE LAW JOURNAL.

129. Wis. Laws 1933, c. 158, § 189.05 (15).

inary finding of unfairness in the proposed issuance of securities, based upon an examination of information required to be filed, and is entirely discretionary with the commission. No attempt seems to have been made to gain exemptions under the latter act.<sup>130</sup> It should, of course, be borne in mind that even where the state commissions have the necessary jurisdiction, it may not extend to interstate transactions.<sup>131</sup>

The possibility that the public service commissions may afford exemptions in connection with public utility reorganizations likewise deserves consideration. There are, broadly, two types of provisions from which the necessary power might be derived—those providing for commission control over the issuance of securities, and those governing merger, consolidation, or reorganization in general. It is rather commonly provided that securities may be issued only with the approval of the commission, which frequently can impose such conditions as it sees fit.<sup>132</sup> Furthermore, the commission is often authorized to hold hearings. The power to allow all interested parties to be heard at these hearings, however, is not always expressly granted. But a still more serious difficulty is that the commission is but seldom empowered to pass upon the fairness of the terms and conditions of the proposed issuance. In most cases, the fundamental object in providing for control over the issue of securities was to prevent overcapitalization,<sup>133</sup> and as a consequence, it is typically provided that the issue is to be approved if it is in the public interest, or for a necessary and legitimate purpose. It seems that in employing these general tests, commissions have occasionally taken possible injustice to existing security holders into considera-

130. Information based upon a communication of Feb. 15, 1936, from the Acting Director of the Securities Division of the Wisconsin Public Service Commission to the *YALE LAW JOURNAL*. The letter states: "We think it would be competent for this department to hold a hearing and notify such persons [prospective recipients of securities] if it thought appropriate. . . . The section does not appear to us to provide the absolute right of the security holders to receive notice of such a hearing, nor does it seem to us to bind the Commission in its judgment if such security holders should at such meeting express their views, one way or the other. Under these interpretations of the provisions of our law, we doubt that, if acted upon, a basis might be established to claim exemption under the federal law." It has been indicated, however, that the hearing need not be mandatory under the state law, the requirements of Section 3 (a) (10) being satisfied if the hearing is authorized and actually held. See Op. of Gen'l Counsel, *supra* note 13.

131. Sales of securities by a seller in one state exclusively to purchasers in other states are seldom governed by the statutes of either jurisdiction. It has been assumed by some that the state commissions could not be given control over such transactions without interfering unduly with interstate commerce. This conclusion, however, is apparently not necessitated by any court decisions. See Klagsbrunn, *Regulation Of Interstate Security Sales—A Recent Report* (1933) 1 *U. OF CH. L. REV.* 88. For the typical attitude, see Doerfer, *The Federal Securities Act Of 1933* (1934) 18 *MARQ. L. REV.* 147, 149; James, *The Securities Act Of 1933* (1934) 32 *MICH. L. REV.* 624, 625; Steig, *What Can The Regulatory Securities Act Accomplish?* (1933) 31 *MICH. L. REV.* 775, 784.

132. For compilations of statutes and discussions, see Heaton, *The Control Exercised By The Michigan Public Utilities Commission Over The Issuance Of Corporate Securities* (1933) 12 *MICH. S. B. J.* 199; Rosenbaum and Lillenthal, *Issuance Of Securities By Public Service Corporations* (1928) 37 *YALE L. J.* 716, 908; Waltersdorf, *State Control Of Utility Capitalization* (1928) 37 *YALE L. J.* 337; *Legis.* (1933) 7 *TEMP. L. Q.* 353.

133. See Waltersdorf, *supra* note 132, at 342.

tion,<sup>134</sup> but even if they were to carry this to the extent of passing on the fairness of reorganization plans, the express statutory authority required by Section 3 (a) (10) would appear to be lacking. Approximately one-half the statutes require the commission's approval of a merger or consolidation,<sup>135</sup> and occasionally the commissioner is given some control over reorganizations of a more general character.<sup>136</sup> But again, the tests upon which the approval is to depend are usually designed to prevent overcapitalization, rather than to insure a fair plan of reorganization. Furthermore, hearings are not often provided for in this connection. In a few instances, however, an exemption for definitive securities may be available under Section 3 (a) (10). For example, the District of Columbia Public Service Commission is authorized to approve the terms of a consolidation, and is given rather broad powers to hold hearings.<sup>137</sup> Likewise, the Maryland statute empowers the commission to approve the issue of securities in connection with a judicial or foreclosure sale, to such an amount and in such a character as appears reasonable and equitable, or proper to protect fully the rights of security holders of the vendor corporation.<sup>138</sup> It, too, is given a blanket authority to hold hearings.<sup>139</sup> But in neither case does the power conferred appear broad enough to justify the exemption of certificates of deposit.

Finally, mention should be made of a rather unique statute<sup>140</sup> recently enacted in Michigan setting up a Public Trust Commission, which is given general supervision over the activities of protective committees. Although the grant of power is not entirely clear, it is possible to construe the act as authorizing the necessary hearings and approvals in regard to deposit agreements. It seems less clear, however, that the statute authorizes similar action in regard to reorganization plans. Nevertheless, the Commission is at present exercising this authority in both instances.<sup>141</sup>

#### CONCLUSION

The foregoing survey of the possible sources of exemptions under Section

134. See Waltersdorf, *supra* note 132, at 354.

135. For a compilation of statutes and discussion, see Hall, *State Control Of Consolidation Of Public Utilities* (1932) 81 U. OF PA. L. REV. 8, 11.

136. See, e.g., N. Y. PUB. SERV. COMM. LAW (1928) § 55-a, (1930) §§ 69-a, 82-a, 101-a, (1931) § 89-g. In New York, the Metropolitan Division of the Department of Public Service is to develop plans involving reorganization for the improvement of city transit. The Division is to hold hearings and "adopt" plans, and the local authorities are to "approve" them, but neither is expressly authorized to pass on the fairness of the plans. *Id.* §§ 122-129. The securities issued in such reorganizations would be exempt in any event under Section 3 (a) (2) of the Securities Act, if issued or guaranteed by the state, a political subdivision thereof, or by a public instrumentality.

137. D. C. CODE (1929) tit. 26, §§ 101, 67-69. The Commission has broad rule-making powers in connection with hearings. *Id.* § 54. And the chapter is to be liberally construed. *Id.* § 118.

138. MD. ANN. CODE (Bagby, 1924) art. 23, § 415.

139. *Id.* §§ 381, 392.

140. MICH. COMP. LAWS (Mason, Supp. 1933) § 290 (1-21), as amended by Laws 1935, No. 218.

141. Information based upon a communication of April 3, 1936, from the Michigan Public Trust Commission to the YALE LAW JOURNAL.

3 (a) (10) leads to the conclusion that the courts, while by no means universally available, have power to afford such exemptions in a substantial number of cases, whereas administrative bodies possessing sufficient authority are few in number, and often limited in jurisdiction to rather specialized situations. This conclusion raises considerable doubt as to the soundness of the premise upon which Section 3 (a) (10) is founded. For the courts do not appear particularly well adapted to accomplish by direct supervision what the Securities Act was intended to achieve. In the first place, the historical concept that courts should remain in a state of inertia until set in motion by litigants, rather than conduct independent investigations,<sup>142</sup> constitutes a serious handicap. For applications for exemptions involving the fairness of deposit agreements, and to a lesser extent, reorganization plans, are often uncontested, and as a consequence, the courts are tending to grant exemptions as a matter of course without detailed consideration, particularly in regard to certificates of deposit.<sup>143</sup> Secondly, experience with the state blue sky laws has demonstrated that supervision of security issues is unsuccessful unless carried out by a specialized and highly trained body. Although our judiciary as a whole is doubtless composed of able men, a heavily burdened court of general jurisdiction can hardly be expected to possess the qualifications or to devote the time necessary to achieve completely effective control.<sup>144</sup> Finally, the courts not only lack facilities for providing the public with facts as a guide to investments,<sup>145</sup> but their approval of a particular plan or agreement may be made to serve as a form of misleading advertisement. On the other hand, administrative bodies, which at present play a comparatively minor role in granting exemptions, might well prove better suited to perform this function than the courts. Typically, they have broad powers of investigation which can be exercised on their own initiative; their work is somewhat specialized in nature, which should make for a high degree of efficiency; and many of them have power to make facts available to the public.<sup>146</sup> Although this superiority in equipment does not of itself ensure perfection in the exercise

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142. See Comment (1936) 20 *MINN. L. REV.* 191.

143. See Dodd, *supra* note 4, at 1121, 1122; Dodd, *Amending The Securities Act—The American Bar Association Committee's Proposals* (1935) 45 *YALE L. J.* 199, 211-214. Recognizing this difficulty, at least one court has adopted the expedient of appointing committees itself, apparently with a view to controlling their activities through the power of removal. See Sabel, *Recent Development In Corporate Reorganizations* (1936) 20 *MINN. L. REV.* 117, 131, n. 75. Even here, however, the court acted on the request of petitioning parties.

144. Cf. Waltersdorf, *supra* note 132, at 337, 338.

145. The extent to which the public may be expected to take advantage of information in choosing investments is perhaps doubtful. See Douglas and Bates, *supra* note 2, at 171, 172. But information concerning the affiliations of protective committee members might prove helpful to security holders contemplating depositing their securities. See Dodd, *supra* note 143, at 213, 214.

146. Many of the state security commissions have power to publish facts which they obtain in the course of investigation. This is less generally true of public utility commissions. The Maryland commission discussed *supra*, however, has this authority. Both the Securities and Exchange Commission and the Federal Power Commission likewise may make information available to the public.

of supervision, the results achieved in at least one instance compare favorably with those obtained through the exercise of judicial control.<sup>147</sup>

Accordingly, if the theory underlying Section 3 (a) (10) is to be adequately carried out in practice, it would seem desirable to effect a shift of the exemption power from the courts to administrative bodies. It may be considered doubtful whether administrative control should be increased by conferring the exemption power on state agencies not expressly authorized by law, since that might result in turning the question over to a body completely unequipped to handle the problem. Probably, more state bodies will be granted express statutory authorization as legislatures become aware of the possibilities afforded by Section 3 (a) (10). It has been suggested that a national administrative body should be created to control the entire field of reorganization, but this has been criticized as impractical.<sup>148</sup> Legislation is now contemplated, however, which would set up a federal agency as a conservator having power to pass on real estate reorganization plans in connection with proceedings under the Bankruptcy Act, or as a condition to reorganization loans by the Reconstruction Finance Corporation.<sup>149</sup> If such an agency were established having power not only over real estate, but likewise over other forms of reorganization, the problem of reorganization exemptions might well be solved by leaving the question exclusively in the hands of that agency and of those state agencies possessing express statutory authorization.<sup>150</sup>

### ADMINISTRATIVE INTERPRETATION OF THE SECURITIES ACT OF 1933

THE introduction, through the Securities Act of 1933,<sup>1</sup> of revolutionary concepts of federal control of the securities market, designed to protect the in-

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147. The California Commissioner of Corporations, is insisting upon the elimination of several of the more undesirable features of deposit agreements. The Michigan Public Trust Commission, however, is for the most part requiring modifications only in regard to fees and expenses charged to depositors.

148. See Gerdes, *Corporate Reorganizations Under Section 77B* (1935) 69 U. S. L. REV. 633, 639; cf. Dodd, *supra* note 143, at 214, n. 22.

149. See (1935) 1 CORP. REORG. 421; N. Y. Times, Feb. 21, 1936, at 23, col. 1.

150. A statute is now being proposed which would establish a federal administrative court having the "jurisdiction and authority now vested in the several departments, commissions, administrations, and other executive agencies of the Government over the revocation of licenses, permits, registrations, or other grants for regulatory purposes. . . ." See McGuire, *The Proposed United States Administrative Court* (1936) 22 A. B. A. J. 197. This jurisdiction would not appear to include power to grant exemptions. Conceivably, such power could be conferred on the court. But an agency acting as conservator in reorganization proceedings would probably be more intimately acquainted with the problems involved, and therefore better adapted to handle the question of exemptions than the proposed administrative court.

1. 48 STAT. 74 (1933), as amended by 48 STAT. 905 (1934); 15 U. S. C. A. § 77 (1935).

vestor,<sup>2</sup> naturally evoked a flood of criticism and comment.<sup>3</sup> On the other hand, the work of the Federal Trade Commission and the Securities and Exchange Commission<sup>4</sup> in molding certain provisions of the Act through interpretation and application, and in filling in and modifying others through the promulgation of rules and regulations, although it impinges more directly upon the conduct sought to be regulated than does the Act, has not as yet been subjected to so searching analysis or discussion. This Comment will examine the pronouncements explaining the meaning and scope of the statutory provisions, which the two commissions have made in the course of their administration of the Act.

The Act does not give the Commission power to interpret its provisions. Even if this power were expressly granted, it is highly doubtful whether such interpretations would be conclusive. The interpretation of statutes has traditionally been the peculiar function of the judiciary. The technique and principles of statutory interpretation, like those of the common law, have arisen out of piecemeal adjudications involving the rights of particular litigants.<sup>5</sup> The doctrine of separation of powers emanating from the Constitution would quite effectively nullify any attempt to vest in an administrative body absolute power to interpret a statute.

Although the Commission has not been authorized to interpret the Act, its

2. By requiring complete and accurate disclosure of information about securities the Act is intended to protect investors from fraud and to give them the basis for an informed judgment as to value.

3. Ballantine, *Amending the Federal Securities Act* (1934) 20 A. B. A. J. 85; Bane, *The Federal Securities Act of 1933* (1934) B. U. L. REV. 35; Dean, *The Federal Securities Act: An Examination by a Critic*, N. Y. Times, Oct. 15, 1933, VIII at 3; Dodd, *Amending the Securities Act—The American Bar Association Committee's Proposals* (1935) 45 YALE L. J. 199; Douglas and Bates, *The Federal Securities Act of 1933* (1933) 43 YALE L. J. 171; Douglas and Bates, *Some Effects of the Securities Act upon Investment Banking* (1933) 1 U. OF CHI. L. REV. 283; Hanna and Turlington, *The Securities Act of 1933* (1933) 28 ILL. L. REV. 482; James, *The Securities Act of 1933* (1934) 32 MICH. L. REV. 624; Kessler, *The American Securities Act and its Foreign Counterparts: A Comparative Study* (1935) 44 YALE L. J. 1133; MacIntyre, *Criminal Provisions of the Securities Act and Analogies to Similar Criminal Statutes* (1933) 43 YALE L. J. 254; Rodell, *Regulation of Securities by the Federal Trade Commission* (1933) 43 YALE L. J. 272; Shulman, *Civil Liability and the Securities Act* (1933) 43 YALE L. J. 227; Teass, *Duty of Directors and others as Prescribed by Section 11 of the Securities Act of 1933* (1934) 20 VA. L. REV. 817. For a more complete bibliography see C. C. H. Stocks and Bonds Law Service, Vol. III 3901 (1936).

4. The Securities Act of 1933 was administered at first by the Federal Trade Commission. On September 1, 1934, its duties were transferred to the Securities and Exchange Commission by virtue of the amendments of 1934. The latter Commission is administering the Act at the present time. The term "Commission" is used in a generic sense in the text of this Comment. Where it is necessary to distinguish between the two commissions, when discussing a particular interpretation, this will be done in the footnotes.

5. Implicit in discussions of the principles of statutory interpretation is the assumption that interpretation is exclusively for the courts. See De Sloovere, *Preliminary Questions in Statutory Interpretation* (1932) 9 N. Y. U. L. Q. REV. 407; De Sloovere, *Steps in the Process of Interpreting Statutes* (1932) 10 N. Y. U. L. Q. REV. 1; De Sloovere, *Textual Interpretation of Statutes* (1934) 11 N. Y. U. L. Q. REV. 538; Landis, *A Note on "Statutory Interpretation"* (1930) 43 HARV. L. REV. 886; Radin, *Statutory Interpretation* (1930) 43 HARV. L. REV. 863.

administration of necessity has entailed numerous opinions as to the meaning and application of many of the statutory provisions. These opinions appear in informal advisory letters sent by the Commission in response to inquiries on particular points of construction,<sup>6</sup> in decisions by the Commission on such matters as the issuance of stop orders, in the appeals by the Commission to the courts for injunctive relief against violations of the Act, and in the orders and regulations promulgated under the Act. The legal effect to be accorded by the courts to these interpretations is of significance to those persons subject to the Act, many of whom rely upon them and all of whom desire to know with some degree of certainty exactly what burdens have been placed upon their activities by the Act. The problem has two aspects: first, whether reliance upon an administrative interpretation that is held erroneous is a good defense against civil or criminal liability; and second, whether an administrative interpretation of a statutory provision from which an appeal has been taken to the courts will be upheld.

In appeals from Commission orders on the ground that the Act has been interpreted erroneously, the courts, while giving weight to the administrative construction, will undoubtedly reserve to themselves the ultimate power to declare what the Act means, and will approach the problem with open minds to preserve this judicial prerogative.<sup>7</sup> Whether this same attitude will be carried over into those cases where the defense of reliance upon an interpretation of the Commission is asserted when the attempt is made to impose civil<sup>8</sup> or criminal<sup>9</sup> liability is not so clear. The traditional view has been to disregard

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6. These informal letters furnish the bulk of the administrative interpretations of the Securities Act. Only a few of them, however, are published in the releases; the others are not available except to their addressees and to the Commission. Almost all letters reflect only the opinion of counsel to the Commission and not that of the Commission itself; and this fact is expressly pointed out in many of the letters.

7. This does not mean that the courts will frequently overrule the Commission, but rather that they will not give conclusive effect to its interpretations merely because it has spoken. It is likely that the Commission and the courts will be in accord in most cases. But cf. *Jones v. Securities and Exchange Commission*, U. S. Sup. Ct. April 6, 1936, U. S. L. Week, April 7, 1936, at 753.

8. The civil liabilities imposed by Section 12 for violation of Section 5. Where the attempt is made to impose civil liability, the courts are less likely to accept the defense of reliance upon an administrative interpretation than in the case of criminal prosecutions; for, to permit the defense in civil cases might deprive by administrative ruling an injured, innocent plaintiff of a statutory remedy to which he would otherwise be entitled. That consideration is lacking in the case of a criminal prosecution. See *Long v. Thompson*, 177 Wash, 296, 31 P. (2d) 908 (1934), noted in (1934) 9 WASH. L. REV. 167. Cf. *People v. Ferguson*, 134 Cal. App. 41, 24 P. (2d) 965 (1933), noted in (1934) 22 CALIF. L. REV. 569.

9. Section 24 imposes penalties upon any person who wilfully violates any of the provisions of the Act. While it might be argued that one who relies upon an interpretation of the Commission which is later held erroneous does not wilfully violate the Act, the term "wilful" has not been given that construction in analogous statutes. To constitute a wilful violation there need be only an intent to do the act that has been prohibited, not an intent to violate a statute. See *State v. Hennessy*, 114 Wash. 351, 195 Pac. 211 (1921); *Commonwealth v. Nichols*, 257 Mass. 289, 153 N. E. 787 (1926); *People v. Marcus*, 261 N. Y. 268, 185 N. E. 97 (1933). See also Sayre, *Public Welfare Offenses* (1933) 33 COL. L. REV. 55.

the defense in such cases.<sup>10</sup> Section 19 (a) of the Act provides: "No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason". Since most of the interpretations given by the Commission appear in informal letters rather than in rules or regulations, this Section will not ordinarily be directly in point, but the arguments in favor of the extension of its spirit to all interpretations are cogent. The Securities Act conditions access to the capital market with considerable burdens. The financial community is entitled to know what these burdens are. But little protection to investors is to be gained by imposing on the financial community the added burden of uncertainty until a court has spoken with finality upon every point of ambiguity. The administrative interpretations have been made by experts in the field of finance who have been reluctant to give interpretations which might restrict the scope of the Act,<sup>11</sup> and who have shown themselves competent to make determinations of a judicial nature upon which reliance may be placed with assurance. Furthermore, it would be unreasonable, in view of the complexity of the Securities Act, for a court to impose upon an individual the burden of outguessing a commission of experts as to what its provisions mean.<sup>12</sup>

The need for administrative interpretation varies from section to section, depending both upon the ambiguity of the legislative text and the nature of the problem involved. The opinions of the Commission as to meaning and application cluster about a few of the more controversial sections. Discussion of the interpretations placed upon the Act section by section appears to be the most convenient and useful method of treatment.

#### DEFINITIONS

Section 2 (1) of the Act defines the term "security" with sufficient breadth to cover the many types of instruments that fall within the concept of a security in the commercial world, expressly including certificates of deposit, investment contracts, voting-trust certificates, fractional undivided interests in oil and gas rights, and warrants or rights to subscribe to a security. The question of whether certain unique types of security interests fall within the definition of a "security" under the Blue Sky Laws of the States has been a

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10. *Hoover v. The State*, 59 Ala. 57 (1877) (criminal); *Hamilton v. The People*, 57 Barb. 625 (N. Y. 1870) (criminal); *State v. Foster*, 22 R. I. 163, 46 Atl. 833 (1900) (criminal); *Long v. Thompson*, 177 Wash. 296, 31 P. (2d) 908 (1934) (civil). *Contra*: *People v. Ferguson*, 134 Cal. App. 41, 24 P. (2d) 965 (1933) (criminal). But see *La Bourgogne*, 210 U. S. 95, 134 (1908) (civil).

11. It is only an interpretation which holds that the Act does not apply to a particular situation or that it does not require a certain mode of conduct which raises the problem of the imposition of liability as a result of acting upon such administrative opinion.

12. For an interesting case arising under a State Blue Sky Law adopting the approach here urged, see *People v. Ferguson*, 134 Cal. App. 41, 24 P. (2d) 965 (1933). Defendant was charged with selling securities without a permit in violation of the Corporate Securities Act of California. His defense was that he had been advised by the Corporation Commissioner that the "trust interests" he contemplated selling were not within the provisions of the Act, and that a permit was therefore unnecessary. His conviction was reversed because the trial court had excluded this evidence.

frequent subject of litigation.<sup>13</sup> While this same kind of question has arisen under the Securities Act and has given rise to many informal opinions on the point by the Commission, the issue is of far more interest than importance. The definition of "security" in the Act is general and flexible enough to control substantially all access to the national capital market, and those interests which appear on the fringes of the definition and introduce doubt in interpretation are of relatively minor significance.

For example, in a suit by the Commission to enjoin a violation of the Act, a Federal District Court upheld the contention of the Commission that the interest involved was a "security" within the Act and enjoined the defendant from using the mails or any means of interstate commerce in selling such securities until a proper registration statement was in effect.<sup>14</sup> The contract, on a standard form, provided that the purchaser invest money with the defendant, a broker, who was to use it at his discretion for trading in commodities and securities for a period of ninety days. At the end of that period profits or losses, which the contract itself characterized as speculative, were to be shared. Such a contract quite clearly appears to fall within the term "investment contract" included in Section 2 (1) and, if offered to the public, as may be inferred from the fact that it was on a standard form, should be registered before being offered for sale.

Section 2 (3) of the Act provides that the term "sale", "sell", "offer to sell", or "offer for sale" shall include every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value. Preliminary negotiations or agreements between an issuer and any underwriter are excluded from the definition. The typical situation, of course, offers no difficulty; but it is the borderline transactions which require interpretation. The definition of a "sale" offers more difficulty than that of a "security", for the transactions to be characterized as sales under the Act are not enumerated so carefully as are interests to be known as securities, and the definition includes many more transactions than those commonly known as sales. The question seems to be not whether any sort of title passed, but rather whether the policy of protecting investors will be advanced by including a particular kind of transaction within the definition of a "sale" and therefore within the jurisdiction of the Commission.<sup>15</sup>

The Commission has applied the concept of sale or offer of sale to numerous transactions. Concerning a proposed issue of bonds carrying a conversion

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13. *Barnhill v. Young*, 46 F. (2d) 804 (S. D. Cal. 1931); *Barrett v. Gore*, 88 Cal. App. 372, 263 Pac. 564 (1928); *Schmoyer v. Van Hosen*, 111 Kan. 759, 208 Pac. 554 (1922); *State v. Ogden*, 154 Minn. 425, 191 N. W. 916 (1923); *State v. Heath*, 199 N. C. 135, 153 S. E. 855 (1930); *Creasy Corp. v. Enz Bros. Co.*, 177 Wis. 49, 187 N. W. 666 (1922).

14. *S. E. C. v. Wickham*, 12 F. Supp. 245 (D. Minn. 1935), noted in (1936) 36 *Col. L. Rev.* 683.

15. For cases involving the application of the definition of a "sale" under the State Blue Sky Laws, see *State v. Dobson*, 140 Kan. 445, 37 P. (2d) 10 (1934); *Edward v. Ioor*, 205 Mich. 617, 172 N. W. 620 (1919); *Link, Petter & Co. v. Pollie*, 241 Mich. 356, 217 N. W. 60 (1928); *Marney v. Home Royalty Ass'n of Okl.*, 34 N. M. 632, 286 Pac. 979 (1930); *Josslyn v. Dahinden-Schmitz Co.*, 208 Wis. 468, 243 N. W. 473 (1932).

privilege which might be exercised at any time after the bonds were issued, the question was raised whether that would constitute a "sale" or "offer to sell" the stock into which the bonds were convertible.<sup>16</sup> In an informal letter the Commission answered that if the conversion right could not be exercised until some future time, the issue of bonds would not involve an offer of the stock, but since that right of conversion was to accrue immediately, the issuer of the bonds would have to register the stock also and pay a registration fee for that stock.<sup>17</sup> In decisions rendered in two stop order proceedings, the Commission held that the distribution free of charge of stock upon which assessments were to be levied for the purpose of financing constituted a sale.<sup>18</sup> In both cases stop orders were issued since the Commission found that the statements to the effect that the stock was to be given away rather than sold were misleading. The Commission has also interpreted within the concept of a sale the typical transactions in which voting trust certificates are delivered against the deposit of securities under the trust and those in which a security is issued in exchange for outstanding securities, claims, or property interests.<sup>19</sup> Since other sections of the Act expressly refer to those transactions and indicate by implication that they are to fall within the jurisdiction of the Commission,<sup>20</sup> the conclusion that they are "dispositions of . . . a security . . . for value" is justified. In an informal opinion the Commission stated that the distribution by a dealer or underwriter of pamphlets of a statistical service, commenting favorably upon securities which he intends to sell in the future, would closely resemble a present offer to sell those securities, and would be prohibited until a registration statement was in effect.<sup>21</sup>

A "sale of securities", in the last analysis, is the jurisdictional basis of regulation by the Commission. Its meaning is broader than its component terms. It is the link between industry and the capital market. Any definition of "security" or "sale" based upon considerations of intrinsic meaning drawn from a strict interpretation of the legislative text rather than upon the realities of the securities market and the policy of the Securities Act to protect investors and to effect more reliable market evaluation of securities would to that extent frustrate the purpose of the Act. The definitions of those terms in the Act are both broad and flexible, and the few interpretations of them which are available out of the many rendered by the Commission indicate that the Commission is thinking of control over the capital market rather than simple and logical definitions to be applied mechanically.

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16. The last sentence of Section 2(3) provides that where the conversion privilege may not be exercised until some future time, the issue of the original securities shall not be deemed a sale of the securities into which they are convertible; but the precise question here involved is not expressly covered by the legislative text.

17. F. T. C. Release No. 97, Pt. 2, Dec. 28, 1933.

18. *In re Gold Producers, Inc.*, 18 F. T. C. 619 (1933); *In re Sierra Nevada, Ltd.*, F. T. C. Release No. 140, March 24, 1934.

19. F. T. C. Release No. 97, Pt. 1, Dec. 28, 1933.

20. Section 2(1) includes a voting trust certificate within the definition of a "security." Section 2(4) defines the issuer of a voting trust certificate as the person performing the acts and assuming the duties of manager pursuant to the provisions of a trust agreement.

21. S. E. C. Release No. 464, August 19, 1935.

*Section 2 (4)* defines an issuer of a security as a person who issues or proposes to issue any security, except that in the case of certificates of deposit, voting trust certificates, collateral-trust certificates, or shares in an unincorporated investment trust not having a board of directors, the issuer is the person performing the duties pursuant to the trust or agreement under which such securities are issued. The issuer of fractional undivided interests in oil, gas, or other mineral rights is defined as the owner of any such right or of any interest in such right (whether whole or fractional) who creates fractional interests therein for the purpose of public offering. This section of the Act has required explanation by the Commission rather than creative interpretation, particularly in respect to fractional undivided interests in mineral rights, which are highly complex and technical. The Commission has divided such interests into five classifications, meaningless, even when defined, to anyone not an expert in the field,<sup>22</sup> and has explained the application of the definition of an issuer to each. The Commission has stated that three points must be considered in determining who is the "issuer" of a royalty interest. An issuer must be the owner of the royalty interest in question. He must create fractional interests therein. And the subdivision must be made for the purpose of public offering.<sup>23</sup> Since such interests are capable of infinite subdivision, it is possible that there may be several issuers of the same royalty interest. All issuers must register, and if they are not residents of the same State, the exemption provided in Section 3 (a) (11) of the Act<sup>24</sup> is not available to them. The lack of interpretations of the definitions of issuers of other types of securities would seem to indicate that the problems encountered in their application have not been serious.

*Section 2 (10)* defines a "prospectus" as any notice, circular, advertisement, letter, or communication which offers any security for sale. Section 5 makes it unlawful to use any means of interstate commerce or the mails to sell<sup>25</sup> such

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22. (1) "Royalty interests"—fractional undivided landowners' oil or gas royalty interests; (2) "working interests"—fractional undivided oil or gas leasehold interests, the holders of which share in all the expense of development or operation of the lease; (3) "free working interests"—fractional undivided oil or gas leasehold interests in a lease, any part of the expense of development and operation of which is borne by persons other than the holders; (4) "over-riding royalty interests"—rights of participation in the oil or gas produced by another, which are unlimited as to amount ultimately to be received; (5) "oil and/or gas payments"—rights of participation in the oil and/or gas produced by another, which are limited in amount. S. E. C. Rules and Regulations under the Securities Act of 1933, Article 5, Regulation B, published in Release No. 627 (Class C) Jan. 21, 1936.

23. The creation of fractional interests for the purpose of public offering, a part of the definition of an issuer of royalty and leasehold interests, has been interpreted not to apply to issuers of "overriding royalties" or "oil or gas payments." The definition applicable to issuers of those two types of interests is "every person who issues or proposes to issue any security." S. E. C. Compilation of Regulations, Forms, and Opinions Applicable to Oil and Gas Interests, Release No. 435, July 13, 1935.

24. Section 3(a) (11) grants exemption to a wholly intra-state issue of securities. This exemption is discussed *infra*, at p. 1090.

25. The term "sell" is, of course, used in the broadest sense as defined in Section 2(3) and includes offer to sell, attempt to dispose of, and solicitation of an offer to buy a security for value.

security through the use or medium of any prospectus or otherwise unless there is in effect a registration statement. Section 8 provides that a registration statement may not take effect until at least twenty days after filing with the Commission. The question arose as to whether it would be proper for an issuer or underwriter to distribute by the use of the mails circulars describing a particular security during the twenty-day waiting period. The purpose of that waiting period was to prevent the recurrence of high-speed, reckless distribution of securities which made impossible careful appraisal and analysis by investors. The Commission stated that buyers must maintain freedom of action during the period and that any binding commitments or offers to buy or sell made prior to the effective date of the registration statement would violate the provisions of the Act covering the waiting period. Since, however, the Commission itself was under the duty to make available to the public information filed with any registration statement,<sup>26</sup> the Commission stated that the distribution of purely descriptive circulars would advance the policy of the Act; but the point was emphasized that such circular must be only informative and should expressly negative any implication that through it anyone is attempting to offer to sell securities or to solicit offers to purchase. That is, it must definitely be not a "prospectus".<sup>27</sup>

Section 2 (11) of the Act defines an underwriter in the following manner: "The term 'underwriter' means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission". It is important under the Act to determine who the underwriters of an issuer are, for the names of the principal underwriters must appear on the registration statement and the civil liabilities of Section 11 are imposed upon every underwriter of an issue. That the definition includes a purchasing banker of an issue which is subsequently to be offered to the public is clear. Whether it also applies to a strict underwriter—one who merely insures' the success of a sale of securities—is more doubtful,<sup>28</sup> but a careful reading of the definition leads to the conclusion that both types of underwriters were intended to be included. The Commission has not yet spoken to clear up that point. The

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26. Section 6 (d) of the Act.

27. F. T. C. Release No. 70, Nov. 6, 1933. See also S. E. C. Release No. 464, August 19, 1935.

28. In H. R. REP. NO. 85, 73d Cong., 1st Sess. (1933) 12, it is stated: "The term (underwriter) is defined broadly enough to include not only the ordinary underwriter, who for a commission promises to see that an issue is disposed of at a certain price, but also includes as an underwriter the person who purchases the issues outright with the idea of then selling that issue to the public." Careful commentators have pointed out, however, that the legislative text does not clearly embody that declaration of intent. See Douglas and Bates, *Some Effects of the Securities Act upon Investment Banking* (1933) 1 U. OF CH. L. REV. 283, 294.

application of the definition to this complex phase of finance has raised many other problems, a few of which have been passed upon by the Commission.

The Commission has stated that a protective committee which, after approval of its plan of reorganization by the bondholders, obtains the securities of the new corporation in connection with the acquisition of the property of the old corporation and distributes those securities to the depositing bondholders, is not an underwriter.<sup>29</sup> The transaction has been characterized as a "sale" by the new corporation to the depositing bondholders with the committee acting as "trustee" or "agent" for the depositors rather than as a distribution of securities through the committee as underwriter. Since the protective committee is considered the issuer<sup>30</sup> of the certificates of deposit which must be registered under the Act unless exempted by reason of some governmental authority's approval of their issuance,<sup>31</sup> and since the final exchange of certificates of deposit for securities in the new corporation in many instances is subject to further supervision by courts or banking, insurance, or securities authorities, there seems to be no need to impose further liability upon the protective committee as underwriter of the new securities. The view of the Commission on that point, therefore, seems justified. In regard to what persons may be considered within the definition of underwriter as participating in the distribution of securities, the Commission has ruled that a person engaged in the business of purchasing the securities of an issuer and then selling its own securities to furnish the proceeds with which to acquire them is to be regarded as an underwriter of those original securities.<sup>32</sup> Although the effect of this ruling is to impose upon such a distributor the liabilities both of issuer of its own securities and underwriter of the others, an opposite interpretation, by permitting the sale of the original securities without the disclosure of any information about their issuer,<sup>33</sup> would permit an ingenious evasion of the strict letter of the Act to frustrate its policy.

All persons taking part in the distribution of securities (members of a selling syndicate and dealers) are included within the definition of "underwriter"—except those whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. This commission has been defined not to include amounts paid to any person whose function is the management of the distribution of all or a substantial part of the particular issue, or who performs the functions normally performed by an underwriter or an underwriters' syndicate.<sup>34</sup> This re-

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29. F. T. C. Release No. 97, Pt. 3, Dec. 28, 1933.

30. Section 2(4) defines the issuer of certificates of deposit as the person performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued.

31. This exemption, provided in Section 3(a) (10), is discussed *infra*, at p. 1088.

32. F. T. C. Release No. 47, Sept. 22, 1933; incorporated in S. E. C. Rules and Regulations under the Securities Act of 1933, Rule 140, Release No. 627 (Class C) Jan. 21, 1936.

33. Since the sale by the original issuer of the entire issue of securities to a single person would be a "transaction by an issuer not involving any public offering," those original securities would be exempt from registration under Section 4(1). This Section is discussed in detail *infra*, at p. 1092.

34. F. T. C. Release No. 96, Dec. 21, 1933 and S. E. C. Release No. 530 (Class C) Oct

strictive definition of the Commission reflects its vigilance in preventing an exception provided in the Act for one purpose, from being expanded beyond that purpose, with resultant emasculation of other provisions.

#### EXEMPTIONS

The Act exempts from its provisions certain enumerated types of securities and transactions. The purpose of such exemptions is twofold. One class of exemptions limits the application of the Act to the distribution of securities rather than to trading in them and restricts its incidence to the issuance of securities in the future. Concerning the second class, within which most of the exemptions fall, Congress has determined that the intrinsic nature of certain securities or the circumstances surrounding their issue in enumerated instances provide adequate protection to investors. Since neither securities nor transactions fall into simple, distinct categories, the application of the exemptive provisions of the Act to the diverse situations in which exemption has been sought has involved difficult questions of interpretation. In the interpretation of these provisions as applied to situations not falling clearly within the ambit of their text, the Commission has a wide field of discretion in either restricting or expanding the application of the Act in accordance with its views of how much protection investors in general and those in particular situations ought to have.

The Act leaves to implication the precise meaning of "exemption from registration". The Commission has stated as its interpretation that where exemption is provided for in the Act, no information need be filed with the Commission and the prospectus form and content may be determined entirely by the issuer or seller.<sup>35</sup> Since exemption from registration carries with it not only freedom from the delay and expense incident to registration but also immunity from the civil liabilities imposed by Section 11 of the Act for false registration statements, the drive for exemption has been strong. The Commission has passed upon numerous situations where it has been contended that there exist the factors necessary for exemption.

*Section 3 (a) (1)* exempts "Any security which, prior to or within sixty days after the enactment of this title, has been sold or disposed of by the issuer or bona fide offered to the public, but this exemption shall not apply to any new offering of any such security by an issuer or underwriter subsequent to such sixty days". The purpose of this exemption is to restrict the application of the Act to appeals to the capital market made after its enactment. Although most of the situations calling for interpretation of this Section clustered around the months immediately succeeding the passage of the Act and many of the problems have receded into the background with the lapse of time, a few of those problems have current significance. The Commission has ruled that stock originally issued before May 27, 1933, but kept in the corporate treasury, must

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18, 1935; incorporated in S. E. C. Rules and Regulations under the Securities Act of 1933, Rule 141, Release No. 627 (Class C) Jan. 21, 1936.

35. F. T. C. Release No. 217, August 29, 1934.

be registered if offered for sale after July 27, 1933.<sup>36</sup> But in a case where stock had been issued to former stockholders and, prior to May 27, 1933, the underwriter had entered into contracts with those stockholders to buy some of their stock, the conclusion was reached that the offering by the underwriter after July 27, 1933 of that stock to the public is not a "new offering . . . by an underwriter" and therefore is exempt under Section 3 (a) (1).<sup>37</sup> A novel situation involved the exemption of certificates of deposit and the securities ultimately deliverable where the solicitation of deposits was begun prior to July 27, 1933. Under the deposit agreement the committee had continuing power to accept deposits, to acquire the mortgaged property and to transfer it to a corporation or trust and to issue corporate stock or trust certificates against it to the depositors, without further submission to the holders. It was held that even though some of the deposits were made after July 27, 1933 and the securities ultimately deliverable were issued after that date, both types of securities were exempt since the offering was made by the issuer prior to July 27, 1933, and since that offering contemplated both certificates of deposit and the securities ultimately deliverable without further action by the holders.<sup>38</sup> It was pointed out that the opposite holding would obtain if the deposit agreement had to be amended after July 27, 1933 to give the committee the continuing power to solicit deposits for a further period.

*Section 3 (a) (3)* exempts "Any note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity . . . of not exceeding nine months". Exemption was sought for nine months collateral trust notes secured by purchase money notes given by members of the public in connection with installment purchases. The finance company which issued the collateral trust notes had purchased the underlying purchase money notes from dealers. The ruling was that the collateral trust notes were exempt, their proceeds being regarded as used for "current transactions" if their issuer was in the business of making loans and if those proceeds were used in making loans upon or buying purchase money notes or in paying off outstanding collateral trust notes exempt under Section 3 (a) (3).<sup>39</sup>

*Section 3 (a) (5)* exempts "any security issued by a building and loan association . . . or similar institution, substantially all the business of which is confined to the making of loans to members . . .". Mortgage loan companies which obtain loans from the R.F.C. in order to relend the proceeds to local industries and mercantile businesses sought exemption for shares of their stock. It was ruled that if the stock of the company is issued only to borrowers or if the stock issued to borrowers carries voting rights in the same

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36. F. T. C. Release No. 131, March 13, 1934.

37. F. T. C. Release No. 97, Pt. 4, Dec. 28, 1933.

38. S. E. C. Release No. 538 (Class C) Oct. 26, 1935.

39. S. E. C. Release No. 401, June 18, 1935, superseding the opinion expressed in S. E. C. Release No. 388, June 8, 1935, to the effect that such collateral trust notes were not exempt.

proportion to their investment as that issued to the organizers, the company was sufficiently similar to a building and loan association to come within the exemption.<sup>40</sup>

*Section 3 (a) (8)* exempts "Any insurance or endowment policy . . . issued by a corporation subject to the supervision of the insurance commissioner . . . of any State". Under this section it was held, assuming the issuer to be under the supervision of the Superintendent of Insurance of New York, that contracts guaranteeing the payment of principal and/or interest due on a bond are to be considered insurance policies and exempt from the Act.<sup>41</sup>

*Section 3 (a) (9)* exempts "Any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange". This section is intended to exempt exchanges of securities which effect a change in the internal capital structure of an issuer and influence the capital market only remotely. A typical example would be an exchange of no-par stock for par stock to reduce the stated capital item in a balance sheet. The application of this section has necessitated numerous interpretations by the Commission. "Commission or other remuneration" has been defined as not including payments for services in effecting but not promoting such an exchange of securities<sup>42</sup> or payments made by the issuer to its security holders in connection with an exchange of securities for outstanding securities, when such payments are part of the terms of the offer of exchange.<sup>43</sup> The Commission has further extended the exemption granted to the exchange of securities by declaring that a "sale" is not involved where, in statutory mergers or consolidations, securities are distributed to the stockholders of the corporation whose assets have been purchased in exchange for those assets.<sup>44</sup> It has been pointed out, however, that mere formal compliance with the requirements of Section 3 (a) (9) will not confer exemption if the real purpose of the transaction is to evade the registration requirements of the Act in the raising of new capital.<sup>45</sup>

The history of the exemption provided in Section 3 (a) (9) offers an interesting illustration of the kind of difficulty encountered, because of the intricacy

40. F. T. C. Release No. 86, Dec. 13, 1933.

41. Letter by Baldwin Bane, Chief of the Securities Division of the Federal Trade Commission, Oct., 1933, C. C. H. Stocks and Bonds Law Service, Vol. III, ¶ 2158.02. In reaching his conclusion, the writer relied upon *Bowers v. Lawyers' Mortgage Co.*, 285 U. S. 182 (1932), and *United States v. Home Title Ins. Co.* 285 U. S. 191 (1932).

42. Letter by the Chief of the Securities Division of the Federal Trade Commission, interpreting Section 4(3) of the old Act. The amendments of 1934 repealed that Section and re-enacted it in modified form as Sections 3 (a) (9) and 3 (a) (10). C. C. H. Stocks and Bonds Law Service, Vol. III, ¶ 2161.03.

43. S. E. C. Rules and Regulations under the Securities Act of 1933, Rule 150. Release No. 627 (Class C) Jan. 21, 1936.

44. S. E. C. Release No. 353, April 30, 1935; S. E. C. Release No. 493 (Class C) Sept. 20, 1935. For a criticism of this interpretation, see Dodd, *Amending the Securities Act—The American Bar Association Committee's Proposals* (1935) 45 YALE L. J. 199, 203.

45. S. E. C. Release No. 646 (Class D) Feb. 3, 1936.

of the subject matter of regulation, in embodying legislative purpose in bold legislative text. In the Act of 1933 this exemption appeared in Section 4 (3) which provided for exempted transactions and not exempted securities. Under that same Section 4 transactions by dealers, within one year of the offering date to the public, were denied exemption. The question early arose whether dealers trading in Section 4 (3) securities within one year after public offering were exempt. The Commission ruled that although the exemption was characterized as an exempted transaction of exchange, it was available along the line of distribution to dealers.<sup>46</sup> When Congress enacted the amendments of 1934, it incorporated this ruling of the Commission into the Act by moving that particular exemption from Section 4 to Section 3, thus characterizing as exempt the security rather than the transaction of exchange. The question next arose whether securities previously received by a controlling stockholder in a bona fide exchange granted exemption under Section 3 (a) (9) should be registered before being offered to the public through an underwriter. Although a literal application of Section 3 (a) (9) exempting the security given in exchange would carry that exemption to the transaction set out above, the Commission ruled that the offer by the controlling stockholder to the public was not exempt. Such a stockholder was held to have become an "issuer" within the meaning of Section 2 (11); and the person through whom he attempted to offer his stock to the public, as the underwriter of such issuer, could not sell those securities unless they had been properly registered by the person actually issuing them.<sup>47</sup>

The reason for these difficulties in statutory expression and administrative interpretation is apparent. Neither Section 4 nor Section 3 completely comprehends the purpose of the exemption sought to be provided. The securities given in exchange are not exempted because of their inherent qualities, nor is it the purpose of the Act to exempt simply the transaction of exchange. The exemption rather is an exemption of securities because of the circumstances surrounding their issue and ultimate distribution to investors. When the circumstances of such exchange and distribution involve no threat of danger to investors if the securities are not registered, full exemption is available to those securities. From that point of view the two administrative interpretations—the first, holding transactions of dealers exempt when the Act called only the transaction of exchange exempt, and the second, holding the sale by the controlling stockholder not exempt when the Act characterized the security as exempt—are explicable. Both holdings, while difficult to sustain by logical reasoning from the words of the Act, reflect an intelligent application of the theory of the exemption to situations which do not fall neatly within the legislative mandate.

*Section 3 (a) (10)* exempts "Any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to

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46. F. T. C. Release No. 97, Dec. 28, 1933.

47. S. E. C. Release No. 646 (Class C) Feb. 3, 1936.

issue securities in such exchange shall have the right to appear, by any court, or by any official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval". This exemption applies to certificates of deposit as well as to securities ultimately deliverable and gives the issuer an alternative: he must either register the securities or procure the proper governmental approval requisite for exemption. Such approval is clearly required as a condition for exemption, and the Commission has had merely to make clear when such approval is proper. The Commission has pointed out that the following three conditions must be met in order that the securities be exempt under Section 3 (a) (10): (1) there must be adequate notice to all persons to whom it is proposed to issue securities of the hearing on the fairness of their issuance, (2) express authorization must include authority to approve the *fairness* of the terms and conditions of the issuance and exchange and not merely authority to approve the terms and conditions, and (3) the need not be mandatory.<sup>48</sup> approving authority must be authorized to hold a hearing, but such hearing

Another exemption of the Securities Act, similar to Section 3 (a) (10) and concerning which there has been considerable doubt and discussion, appears in Section 77B (h) of the Bankruptcy Act. It is there provided that "All securities issued pursuant to any plan of reorganization confirmed by the court. . . and all certificates of deposit representing securities of or claims against the debtor which it is proposed to deal with under any such plan, shall be exempt from all the provisions of the Securities Act. . .". It was not clear whether confirmation by the court was essential under Section 77B (h) of the Bankruptcy Act for the exemption of certificates of deposit, but the Commission's interpretation was that the term "such" referred back to "any plan. . . confirmed by the court" and therefore the exemption afforded by Section 77B (h) of the Bankruptcy Act applied only to certificates of deposit issued subsequent to the court's confirmation of a plan.<sup>49</sup> This result, similar to that obtaining under Section 3 (a) (10), practically nullified the exemption granted in Section 77B (h) of the Bankruptcy Act since solicitation of deposits typically precedes approval by a court. The Commission has indicated, however, that deposits may be solicited without registration where such deposits do no more than evidence approval of a plan proposed by a reorganization committee. Thus, in its efforts to mitigate abuses incident to reorganization, the Commission has attempted to persuade reorganization committees to abdicate the broad powers which formerly were granted them in deposit agreements by offering in return exemption from registration for certificates of deposit. These views of the Commission on the meaning of Section 77B (h) of the Bankruptcy Act are of the utmost importance in guiding reorganization policy and procedure. The problems involved are complex and significant, and the worth

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48. S. E. C. Release No. 312 (Class C) March 15, 1935.

49. S. E. C. Release No. 296 (Class C) Feb. 15, 1935. See also letter of Aug. 24, 1934, by Chief of the Securities Division of the Federal Trade Commission to Goldwater & Flynn, reported in C. C. H. Stocks and Bonds Law Service, Vol. III, ¶ 2162.05.

of the interpretations by the Commission in the light of those problems has been the subject of extensive comment.<sup>50</sup>

*Section 3 (a) (11)* exempts "Any security which is a part of an issue sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory". While it may be true that most such intra-state issues are small and do not offer serious threat of danger to investors if exempt, that conclusion is by no means inevitable. The exemption appears to have been motivated by considerations of constitutional limitations upon federal power rather than by considerations of financial policy. The Commission, bearing out this view, has held that Section 3 (a) (11) does not exempt securities sold within a State before a registration statement which has been filed is in effect, if the entire issue is not to be sold within that State.<sup>51</sup>

In its numerous opinions on the application of Section 3 (a) (11) to various other situations the Commission has shown an appreciation of the realities involved and has striven to give that provision meaning in terms of the entire policy of the Act. It has been stated that the submission of a plan of reorganization involving the issuance of certificates of deposit to a resident attorney for non-resident bondholders was really a submission to the non-resident principals and therefore the certificates were not exempt.<sup>52</sup> On the other hand, it was held that the forwarding of an offer of a security addressed to a person within the State to a point outside would not involve the loss of an exemption otherwise available to an intra-state issue; the offeror was advised, however, not to accept a subscription received from such non-resident.<sup>53</sup> Concerning the exemption under Section 3 (a) (11) of fractional, undivided interests in oil, gas, or other mineral rights, the Commission pointed out that it would be necessary to consider carefully the type of interest involved and the applicable definition of the term "issuer". It was indicated that in the case of many royalty and leasehold interests it might be found that the conditions of the exemption could not be met because two or more issuers of the same interest resided in different States.<sup>54</sup>

The Commission has ruled that the conditions which must be met to secure exemption for an intra-state issue relate only to the original issue of securities and that residents of the one State may later sell their securities outside that

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50. Dodd, *Reorganization Through Bankruptcy: A Remedy for What?* (1935) 48 HARV. L. REV. 1100; Dodd, *Amending the Securities Act—The American Bar Association Committee's Proposals* (1935) 45 YALE L. J. 199; Spaeth and Friedberg, *Early Developments under Section 77B* (1935) 30 ILL. L. REV. 137; Comment (1934) 34 COL. L. REV. 1348; Comment (1936) 45 YALE L. J. 1050.

51. F. T. C. Release No. 97, Pt. 10, Dec. 28, 1933. At the time this interpretation was made, the exemption of an intra-state issue was provided for in Section 5(c) of the Act. The amendments of 1934 placed this exemption in Section 3(a) (11).

52. F. T. C. Release No. 97, Pt. 9, Dec. 28, 1933.

53. F. T. C. Release No. 97, Pt. 12, Dec. 28, 1933.

54. S. E. C. Compilation of Rules, Regulations, Forms and Opinions Applicable to Oil and Gas Interests, Release No. 435, July 13, 1935. See also C. C. H. Stocks and Bonds Law Service, Vol. III, ¶ 2642B.

State without violating the Act, if the original conditions are met in substance as well as form.<sup>55</sup> Sales made by an issuer to residents are not exempt under Section 3 (a) (11), however, if there results further distribution of those securities in other jurisdictions. Whether the purchasers within the State are "ultimate investors" is the decisive issue—a complex question of fact which can be determined only with reference to the particular circumstances of each case.

The attempt of the Brooklyn Manhattan Transit Corporation to secure exemption under Section 3 (a) (11) furnishes an illustration in point. That corporation issued \$8,000,000 worth of bonds and sold them all to four banking firms in New York City. Believing this sale within the State of New York satisfied the requirements for exemption under Section 3 (a) (11), counsel for the issuer advised their client that the bonds did not require registration under the Securities Act. After the bonds had been sold to the public, temporary registration was sought for them on the New York Stock Exchange under the Securities and Exchange Act of 1934. The Commission, believing the Securities Act had been violated, withheld registration for trading. The issuer thereupon filed a registration statement for the bonds under the Securities Act. After the Securities Act had been complied with in this manner, the Commission granted registration for trading on the New York Stock Exchange and explained the grounds of its former refusal in a well-documented opinion in which the evidence was carefully reviewed.<sup>56</sup> The Commission found that four months after the issuance of these bonds \$1,198,000 (approximately 15%) of them had found their way through the hands of underwriters, subunderwriters, and dealers to non-resident investors. The Commission concluded that the issuer knew that the four banking firms purchased the bonds as "underwriters" with a view to distribution, and that since the non-residents purchasing 15% of the bonds and not the four banking firms were the ultimate investors, the exemption of Section 3 (a) (11)—relating to an issue sold only to persons resident within a single State—was not available for these bonds. An opposite interpretation would have given to the exemption provided in Section 3 (a) (11) an unjustifiably broad meaning and would have permitted a serious inroad into the effective scope of the Act.

Section 3 of the Securities Act, which deals with exempted securities, makes no general provision concerning voting trust certificates, certificates of deposit, or "when, as, and if issued" contracts representing exempted securities. In several opinions the Commission has held that neither voting trust certificates nor certificates of deposit representing exempt securities are exempt on that account, since in each case the issuer is some one other than the issuer of the security expressly exempted and neither the issuer nor the circumstances of issue have those characteristics upon which the exemption of the underlying securities was predicated.<sup>57</sup> Congress has indicated by the amendments of 1934 that it approves this interpretation by the Commission.<sup>58</sup> Standardized con-

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55. F. T. C. Release No. 97, Pt. 11, Dec. 28, 1933.

56. *In re Brooklyn Manhattan Transit Corp.*, 1 S. E. C. 147 (1935).

57. F. T. C. Release No. 86, Dec. 13, 1933; F. T. C. Release No. 97, Pt. 8, Dec. 28, 1933.

58. While Section 3(2), exempting securities issued by the United States or any State,

tracts constituting obligations to take certain securities on a "when, as, and if issued" basis were similarly declared by the Commission to be not exempt if issued by some one, such as a broker or dealer, other than the issuer of the exempt securities underlying those contracts; but if the issuer of the underlying securities also issued certificates for such securities on a "when, as, and if issued" basis, an exemption available to such securities was declared also available to the certificates.<sup>59</sup>

Section 4 (1) of the Act enumerates transactions which are exempt from the Act. These are transactions by any person other than an issuer, underwriter, or dealer, and transactions by a dealer except those within one year after the security was offered to the public. These exemptions broadly limit the scope of the Act to regulation over the distribution of securities rather than trading in them. The second clause of Section 4 (1) exempting "transactions not involving any public offering" appears to be out of place in Section 4, for it relates to distribution and not trading and the purpose of Congress seems to have been to exempt the securities so offered rather than the mere transaction of issuance. The Act does not define "public offering" and the doubts which have arisen have called for numerous expressions of opinion by the Commission on its meaning.

Although the Act appears restricted to "public offering" of securities<sup>60</sup> and although the term has been judicially defined upon numerous occasions in cases under the British Companies Act<sup>61</sup> and the Blue Sky Laws of various states,<sup>62</sup> its meaning in the Securities Act is far from certain. A definition of "public offering" will be useful only to the extent that it advances the purpose of the exemption which that term delimits. The reason for the exemption is obvious. In an offering to a small, select group of associates or investors, particularly in the case of prospective stockholders of a closed corporation, it may reasonably be assumed that such offerees either are intimately acquainted with the affairs of the issuer or are in a position to bargain for adequate disclosure of significant facts. Consequently the protection of their interests does not require the imposition upon the issuer of the burden of disclosure incident to registration. Realizing that the purpose for which the exemption was intended could not be furthered by a simple, clear definition of "public offering", the Commission has wisely refrained from such an attempt; but

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was amended to include certificates of deposit for those securities, no other exemptive provision of the Act has been similarly amended.

59. See summary of oral statement by Chief of the Securities Division of the Federal Trade Commission reported in C. C. H. Stocks and Bonds Law Service, Vol. III, ¶ 7611.

60. While a close analysis of the Act indicates that all its provisions are not expressly limited to public offerings, authorities on the Act convey the impression that its provisions are intended to regulate only offerings to the public. See Douglas and Bates, *Some Effects of the Federal Securities Act Upon Investment Banking* (1933) 1 U. OF CHICAGO L. REV. 283.

61. *Nash v. Lynde*, [1929] A. C. 158; *Sherwell v. Combined Incandescent Mantles Syndicate*, 23 T. L. R. 482 (1907).

62. *Robertson v. Business Boosters' Country Club*, 210 Ala. 460, 98 So. 272 (1923); *Robertson v. Business Boosters' Country Club*, 212 Ala. 621, 103 So. 576 (1925); *In re Leach*, 215 Cal. 536, 12 P. (2d) 3 (1932).

on the contrary has stated that whether or not a particular offering is public is a complex question of fact, in the determination of which the surrounding circumstances of each case are relevant. Among the factors to be considered are the number of offerees and their relationship to each other and to the issuer, the number of units offered, the size of the offering, and the intent of the offeree in purchasing, that is, whether for investment or resale.<sup>63</sup> The Commission has pointed out that it is the size of the group of persons to whom the offer is open that is considered important rather than the size of the group to whom the securities are actually offered or sold, and that a private sale to an underwriter or dealer for the purpose of resale to the public quite definitely cannot be included within the exemption of Section 4 (1).<sup>64</sup>

Applying these principles, the Commission has stated that an offer to 2,450 employees of the issuer was public and therefore not exempt<sup>65</sup> and that an offer addressed to stockholders of an issuer may be a public offer if the number of stockholders is substantial.<sup>66</sup> Concerning an offer of \$1,766,000 of preferred stock to 25 offerees, the Commission gave no opinion—but merely enunciated the principles set forth above and left the decision as to the necessity of registration with the issuer,<sup>63</sup> with the prospect of criminal and/or civil liability as the penalty for a wrong guess.<sup>67</sup> While the reluctance of the Commission to commit itself on an unequivocal definition of “public offering” and its refusal to exempt offerings to stockholders and employees are not invulnerable to criticism, its attitude carries out the policy of the Securities Act by insuring that only in those cases where it is reasonably certain that offerees bargain with an adequate background of knowledge, which is hardly the case with employees and stockholders of large corporations, should the issue be considered to fall within the exemption of Section 4 (1).<sup>68</sup>

The Commission has further ruled that the exemption granted to “transactions not involving any public offering” is not lost if the issuer subsequently decides to make a public offering of securities of the same character and files a registration statement.<sup>69</sup> Since the character of a private offering, which is the basis of the exemption, is not affected by a subsequent public offering, such a

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63. S. E. C. Release No. 285, Jan. 24, 1935.

64. S. E. C. Release No. 603 (Class C) Dec. 16, 1935.

65. F. T. C. Release No. 97, Pt. 6, Dec. 28, 1933. It is significant to note that an amendment to the Act expressly exempting offers to employees was rejected on the ground that such offers were already exempt as not involving a public offering. See C. C. H. Stocks and Bonds Law Service, Vol. III, ¶ 2203.06.

66. F. T. C. Release No. 97, Pt. 5, Dec. 28, 1933.

67. Whether civil liabilities under Section 11 will be imposed for false registration statements filed by an issuer who erroneously believed himself subject to the Act cannot be answered clearly in the negative. In a somewhat analogous situation the Commission has ruled that material information given, but not called for in the registration statement, when false, may constitute grounds for the issuance of a stop order. In *re Unity Gold Corp.*, 18 F. T. C. 649, 653 (1934).

68. See Dodd, *Amending the Securities Act—The American Bar Association Committee's Proposals* (1935) 45 YALE L. J. 199, at 205-208, for a defense of the Commission's interpretations relating to public offerings.

69. S. E. C. Release No. 305, March 2, 1935.

result is entirely consistent both with the previous attitude of the Commission and the purpose of the exemption.

*Section 4 (2)* exempts "Brokers' transactions, executed upon customers' orders on any exchange or in the open or counter market, but not the solicitation of such orders". The Commission has pointed out that even though such transactions are exempted in general terms, the exemption applies only to the broker's half. Whether or not his customer is also exempt depends entirely upon the status of the customer and the type of transaction in which he is engaged. Where the broker's customer was an issuer which sought some other exemption for its securities to which they were not entitled, it was stated that such issuer could not sell through a broker on the stock exchange without registering those securities.<sup>70</sup> Although this interpretation does not come from the textual confines of *Section 4 (2)*, the restriction it places upon the literal meaning of that Section may be justified without difficulty. In general, the application of the Securities Act is limited to the distribution of securities rather than trading in them. The purpose of the exemption provided in *Section 4 (2)* is to assure an open market for securities in the hands of investors at all times, even though a stop order may have been entered prohibiting further distribution, and thus to prevent investors from suffering vicariously for the wrongs of an issuer. To extend exemption under *Section 4 (2)* to an issuer distributing securities through a broker would quite clearly be inconsistent both with the purpose underlying that Section and with the policy of the entire Act.

#### STOP ORDERS

*Section 8 (a)* provides that a registration statement shall become effective 20 days after it has been filed with the Commission. *Section 8 (b)* authorizes the Commission, after opportunity for hearing, to refuse to permit a registration statement to become effective if on its face it is incomplete or inaccurate in any material respect and if the Commission gives notice of the hearing within 10 days after the filing date. Since the investigation under *Section 8 (b)* is restricted to the registration statement itself and must be made hastily, it is rather under *Section 8 (d)* that the Commission has acted to protect investors.

*Section 8 (d)* gives the Commission power, after opportunity for hearing, to issue a stop order at any time suspending the effectiveness of a registration statement if it appears to the Commission "that the registration statement includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading". The Commission has issued numerous stop orders under *Section 8 (d)*,<sup>71</sup> and in the well-documented decisions accompanying many of those orders it has been able to articulate its views as to the meaning of that subsection. At the outset it is to be noted that under the Securities Act the

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70. F. T. C. Release No. 131, March 13, 1934.

71. As of April 1, 1936, 102 such orders had been issued, of which 75 were still in effect.

Commission is merely an office for the registry of information about securities.<sup>72</sup> Its function under Section 8 is limited to an investigation of the truth and completeness of information contained in registration statements. The Commission may go no further. It may not refuse or suspend registration because it considers a security speculative or inequitable, a power granted to administrative agencies under the Blue Sky Laws of many of the States.<sup>73</sup>

One problem which has arisen under Section 8 (d) is the time in reference to which the truth of any statement at issue is to be tested. In view of the requirement of Section 11 (a), which sets forth the time when the registration statement became effective as the criterion for civil liability for a false statement, the Commission has determined that it is without power to issue a stop order if it finds that a statement reflected the truth as of the time the registration statement became effective, even though subsequent changes in the condition of the issuer render such statement no longer true.<sup>74</sup>

A more difficult question—the crucial question under Section 8 (d)—is what is a material fact the false statement or omission of which furnishes grounds for the issuance of a stop order. The misrepresentation of a fact and its materiality, which latter point was closely related to reliance by plaintiff, are elements of the common law action of deceit.<sup>75</sup> The Commission's treatment of "material fact" in its decisions on the issuance of stop orders is reminiscent of those actions in deceit, for although reliance is not an element of the civil remedies provided in the Act, the Commission has defined a material fact as "a fact which if it had been correctly stated or disclosed would have deterred or tended to deter the average prudent investor from purchasing the securities in question".<sup>76</sup> That definition adds but little substance to the term "material fact". As in the case of "reasonable man", "preponderance of evidence", or "proximate cause", any attempt at further definition is likely to be merely the repetition of verbal formulas. A "material fact"—in the abstract without reference to a specific case—is a material fact. Whether a certain fact is "material" in particular circumstances is a matter of judgment which involves a consideration of the numerous problems sought to be solved by regulation of the securities market. A comprehensive definition of "material fact" would be an

72. "The public should thoroughly understand that the Commission is not authorized to pass in any sense upon the value or soundness of any security. Its sole function is to see that full and accurate information as to the security is made available to purchasers and the public, and that no fraud is practiced in connection with the sale of the security." F. T. C. Release No. 1, May 27, 1933.

73. CAL. GEN. LAWS (Deering, 1931) art. 3814, § 4; 2 MICH. COMP. LAWS (1929) § 9780; NEB. COMP. STAT. (1929) 81-5408; Wis. Laws 1933, c. 158, § 189.07.

74. In re Howard, 18 F. T. C. 626 (1934). Sections 12 and 17 of the Act, however, provide a remedy in such situation.

75. For a concise summary of the elements of the action of deceit, see Shulman, *Civil Liability and the Securities Act* (1933) 43 YALE L. J. 227.

76. In re Howard, 18 F. T. C. 626, 629 (1934). Two English cases adopting that definition in reference to the British Companies Act were relied upon by the Commission: *Smith v. Chadwick*, 9 App. Cas. 187 (1883); *Broome v. Speak*, [1903] 1 Ch. 586, aff'd, [1904] A. C. 342.

illusion. Its meaning may best be gathered from a study of its application to diverse situations.

Several difficulties must first be considered. The materiality of deficiencies alleged by the Commission is seldom questioned by issuers and as a result the Commission in its decisions on stop orders considers whether statements are false or their omission misleading without discussing materiality as such.<sup>77</sup> A further difficulty is that since many of the decisions consider as many as six or more material deficiencies in registration statements, the true ratio decidendi of any particular decision is often undeterminable.

In the application of the concept of "material fact" in the decisions on the issuance of stop orders, the first question to be considered is what is a fact. Literally and in the orthodox action in deceit a statement of fact is a statement of existing relationships whose truth can be tested objectively. An opinion, promise, or prophecy is not a fact, and in theory does not fall within the purview of Section 8 (d); but, just as in the action of deceit, or a suit to cancel a contract of purchase for fraud,<sup>78</sup> the concept of fact has been extended to cover these statements of less objective realities. In one decision the Commission regarded a prophecy that cash would be distributed to depositing bondholders, known to be untrue as of the time it was made, as an untrue statement of fact since it misstated the mind of the person making the prophecy.<sup>79</sup> A statement in a registration statement that profits of \$250,000 were contemplated from a contract for the sale of gravel was held a false statement of fact where the issuer was bound to know that the contract was impossible of performance and that such expectation of profits was fantastic.<sup>80</sup>

The decisions of the Commission on the issuance of stop orders dealing with facts fall into three categories: those dealing with (1) the false statement of a material fact, (2) a statement misleading because of the omission of a material fact, and (3) a statement misleading because of the manner in which material facts are stated.

The decisions on untrue statements of material facts are numerous. Overvaluation of assets and flagrant departure from the standards of appraisal purported to have been followed have been held within that category.<sup>81</sup> Other statements held to be false statements of material facts were an engineer's report of value based upon a romantic, unfounded hope,<sup>82</sup> a statement that an issuer was engaged in the business of manufacturing mechanical devices when

77. See, e. g., *In re American Gyro Co.*, 1 S. E. C. 83 (1935); *In re Big Wedge Gold Mining Co.*, 1 S. E. C. 98 (1935).

78. *California Credit and Collection Corp. v. Goodwin*, 76 Cal. App. 785, 246 Pac. 121 (1926) (representation that plan would be located in certain county held representation of a material fact); *H. W. Smith, Inc. v. Swenson*, 105 Cal. App. 60, 286 Pac. 1050 (1930) (representation of future dividends held one of fact); *Buhler v. Loftus*, 53 Mont. 546, 165 Pac. 601 (1917) (statement that company would start business in two months held a material fact).

79. *In re Commonwealth Bond Corp.*, 18 F. T. C. 635, 648 (1934).

80. *In re Brandy-Wine Brewing Co.*, 1 S. E. C. 123 (1935).

81. *In re Haddam Distillers Corp.*, 1 S. E. C. 37 (1934); *In re Continental Distillers and Importers Corp.*, 1 S. E. C. 54 (1935).

82. *In re Plymouth Consolidated Gold Mines, Ltd.*, 1 S. E. C. 139 (1935).

substantially all of its business was printing,<sup>83</sup> and a statement that stock was not to be sold but was to be given away, when actually such stock was assessable for the purpose of financing.<sup>84</sup>

The decisions on the issuance of stop orders contain abundant instances of the Commission's judgment as to what are omissions to state a material fact required to make a registration statement not misleading. The following omissions, among others, were found to fall within that category: neglect of an engineer to state that some of the shafts he included in his report on the appraisal of mining property were filled with water,<sup>85</sup> failure of the president of an issuer to state that he had owned a lease and option which he sold to the issuer,<sup>85</sup> omission to state that a rival committee was soliciting deposits of securities,<sup>86</sup> and failure to record that the regulatory bodies of three states had denied the issuer permission to sell securities.<sup>87</sup> The last three statements had been omitted from registration statements notwithstanding the fact that questions in the registration forms expressly called for such information.

A third category into which the deficiencies warranting the issuance of stop orders have fallen, a category not expressly provided for in Section 8 (d), is the most interesting. It is not the false statement of a material fact nor a material omission which renders a registration statement misleading, but simply a statement which, while literally true, conveys a false impression because of the manner of its expression. While specific legislative warrant for the issuance of a stop order because of a veiled truth conveying a misleading impression may not be found in Section 8 (d), legalistic indeed would be a judge who held that false statements alone, and not false impressions, justify the issuance of a stop order. Under the flexible concept of false or misleading impression, the Commission has become more than simply an office for the registration of complete information about securities and has issued stop orders suspending the effective registration of securities which it would probably bar as "unsound" or "speculative" if it had that power. When disclosure of information about such securities becomes complete and frank by amendment, however, the Commission may no longer withhold registration; but such disclosure may reasonably be expected to dampen considerably the public ardor to buy.

The registration statements which the Commission has found to convey false impressions reflect a high degree of ingenuity. In a plan of investment for school teachers, the bonds offered contained the figures "\$1,000" prominently displayed and underneath in fine type the statement "(Consisting of \$750 cash and \$250 stock)". The Commission found that statement misleading in view of the fact that the stock valued at \$250 had been sold to the promoters at \$.50 and was carried on the balance sheet at that same low figure.<sup>88</sup> In another

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83. *In re American Gyro Co.*, 1 S. E. C. 83 (1935).

84. *In re Gold Producers, Inc.*, 18 F. T. C. 619 (1933); *In re Sierra Nevada, Ltd.*, F. T. C. Release No. 140, March 24, 1934.

85. *In re Franco Mining Corp.*, S. E. C. Release No. 650, Feb. 5, 1936.

86. *In re Howard*, 18 F. T. C. 626 (1934).

87. *In re American Gyro Co.*, 1 S. E. C. 83, 92 (1935). See also *In re The Trinity Corp.*, F. T. C. Release No. 72, Nov. 10, 1933.

88. *In re National Educators Mutual Ass'n, Inc.*, 1 S. E. C. 208 (1935).

case, the Commission held that the characterization of a man without scientific training, who used a fantastic vibrator to find and value gold, as a "world renowned geologist" was most misleading.<sup>89</sup> In a chain scheme of investment where every investor was to put in one dollar and persuade four others to invest the same amount, and those four each to persuade four more, and so on, it was stated that if this process were carried to the sixth stage, each original investor would receive \$729. The Commission issued a stop order, holding the hope of realization visionary and the whole scheme misleading.<sup>90</sup> A "stockholders' protective plan" in a speculative oil venture provided that out of every \$100 contributed, \$70 would be invested in oil and \$30 in a trust fund consisting of safe bonds. In twenty years that \$30 would have increased to \$100 and the stockholder was given the option to turn in his stock at that time and get back his original investment. The Commission held it misleading to characterize the plan as safe since the investor himself could invest his money in those proportions and at the end of twenty years he would have both stock and bonds.<sup>91</sup> In another decision in which a stop order was issued, a report on the geology of mining property which contained such statements as: "Massive tuffaceous andesitic and rhyolitic of various thickness also form a part of the Devonian formation", was characterized by the Commission as unintelligible and abounding in "meaningless, high sounding, pseudo-scientific phrases designed principally to impress the uninformed."<sup>92</sup>

It may be gathered from the above examples that "material untruth", "material omission", and "statement misleading in a material respect" quite successfully defy close definition. When a statement has been required in the registration form promulgated by the Commission for that particular type of security, its omission may *prima facie* be considered material. As for untruths, misleading statements, and omissions of parts of statements required in the forms, their materiality depends not on whether they would tend to mislead an ordinarily prudent investor, a test impossible of application, but rather on whether the issuer's disclosures have come up to the standard of frankness and completeness which the Commission and the courts think the Act demands. That determination is quite different from discovering the subjective rationalization of a non-existent average prudent investor and encompasses more significant considerations. As compared to the traditions underlying the flotation of securities prior to the Act, the standard of honesty and fullness of disclosure which the Commission has found in the Act is very high. It is doubtful, however, that the courts will find that the Commission has misinterpreted the Act. In many cases in which stop orders were issued the issuer has agreed with the Commission and consented to the entering of the order,<sup>93</sup> and in practically all

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89. In re La Luz Mining Corp., S. E. C. Release No. 518, Oct. 11, 1935.

90. In re Wee Investors Royalty Co., 1 S. E. C. 202 (1935).

91. In re Oil Ridge Oil and Refining Co., S. E. C. Release No. 522, Oct. 15, 1935.

92. In re Franco Mining Corp., S. E. C. Release No. 650, Feb. 5, 1936. The Commission indicated its disapproval of the language used, but pointed out that a proper objection could not be made to a report simply because it makes use of technical terms.

93. See, e. g., In re Continental Distillers and Importers Corp., 1 S. E. C. 54 (1935); In re General Income Shares, Inc., 1 S. E. C. 110 (1935); In re National Educators Mutual Ass'n, Inc., 1 S. E. C. 208 (1935).

of them the decisions have been so well documented and fortified with evidence on numerous "material" deficiencies that one is convinced that the necessity for protection to investors far outweighs the claim of the particular issuers to unhampered access to the capital market.

#### CIVIL LIABILITIES

Section 11 of the Act imposing civil liabilities for false registration statements goes far beyond the common law action in deceit to give investors an effective remedy, but its primary function is to furnish an incentive for full and frank disclosure by issuers. The provisions of this Section are quite complex and have been the subject of extensive comment,<sup>94</sup> but as yet have not been authoritatively passed upon by any court in a suit for damages.<sup>95</sup> While the interpretation of this Section is exclusively for the courts in which civil suits are brought, the Commission has expressed several informal opinions as to what it thinks various provisions mean. Two opinions in particular are of interest even though now moot since Congress, to clarify latent ambiguities, incorporated both into the Act by the amendments of 1934. The first opinion was to the effect that it was very unlikely that an underwriter's liability would ever exceed the aggregate amount at which securities were offered to the public.<sup>96</sup> Section 11 (e), as amended, now provides: "In no event shall any underwriter . . . be liable in any suit . . . for damages in excess of the total price at which the securities were offered to the public". The second opinion stated that a person suing under Section 11 (e) in cases where he had sold his securities at a price in excess of the offering price could recover no damages.<sup>96</sup> That result, although highly desirable, was far from clear from Section 11 prior to the amendments of 1934, and the Commission encountered some difficulty in reaching it under the terms of the Act. The Amendments obviated that difficulty by providing that in subtracting selling price or value from purchase price to measure damages, the purchase price shall not exceed the value at which the security was offered to the public.

#### CONCLUSION

The Commission's interpretations of Sections of the Securities Act are tentative. They are subject to review by the courts, whose function it is to determine, in proper cases, what the law is. Whether these courts will invoke strict, orthodox canons of interpretation to construe the legislative text as it is

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94. Shulman, *Civil Liability and the Securities Act* (1933) 43 YALE L. J. 227; Comment (1934) 34 COL. L. REV. 1090; Comment (1933) 19 ST. LOUIS L. REV. 76; Comment (1935) 44 YALE L. J. 456.

95. At least one suit has been instituted, however, in the attempt to assert the civil remedies provided in Section 11. Sixteen stockholders of the Continental Distillers and Importers Corp. brought suits in the Supreme Court of the District of Columbia against the corporation and five of its officers to recover the amount of their stock investments, alleging that provisions of the registration statement are false. N. Y. Times, Jan. 25, 1936, at 21, col. 6.

96. F. T. C. Release No. 45, Sept. 22, 1933.

written or will affirm the interpretations of the Commission framed in the light of the broad policy of adequate control over access to the securities market is a question which must await future decisions for definite answer. In the larger sense, whether the construction of the Act by the Commission has been statesmanlike and effective for the solution of the problems to be met will never be answered with any degree of certainty; for, not only are clear criteria for objective appraisal of the work of the Commission lacking, but it must be recognized that statutory interpretation is only a small segment of the Commission's broad task and its success or failure in that particular field cannot easily be segregated from its other functions of administration.

## PROGRESS IN INTERSTATE ADJUSTMENT OF THE PLACE OF TRIAL OF CIVIL ACTIONS: I

THE common law distinguishes traditionally between jurisdiction and venue. Jurisdiction is said to be based on physical power over person or property.<sup>1</sup> Venue, on the other hand, concerns the doctrines determining whether a court which has the requisite jurisdiction is an appropriate place for trial. Originally all actions were local and had to be tried where the issuable facts occurred. As a result of this dual doctrine of local venue and of jurisdiction depending solely on physical power, the plaintiff often found that the only court which had jurisdiction had to dismiss his action because of improper venue, while the only court with proper venue lacked jurisdiction.<sup>2</sup> This paradox was early resolved to a large extent by making the great majority of actions transitory and triable in any court with jurisdiction over the defendant or his property, the venue requirement in such cases becoming a mere formality.<sup>3</sup> But even within the category of transitory actions, application of the physical power concept frequently led to inequitable results: it sometimes favored an elusive defendant, by unduly impeding the prosecution of meritorious claims, and at other times afforded the plaintiff an unreasonably wide choice of forums, with a consequent opportunity to inconvenience the defendant and hamper a fair presentation of the latter's case.<sup>4</sup>

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N. B. Many phases of the problem of determining the state of forum of civil actions have been quite adequately discussed hitherto as more or less isolated issues. The purpose here is to delineate the problem as a whole and simply to observe the progress that has been made toward its solution.

1. See *McDonald v. Mabee*, 243 U. S. 90, 91 (1917); Dodd, *Jurisdiction in Personal Actions* (1929) 23 ILL. L. REV. 427; Comment (1925) 34 YALE L. J. 415.

2. *Livingston v. Jefferson*, 15 Fed. Cas. No. 8,411, p. 660 (C. C. Va. 1811).

3. See SCOTT, *FUNDAMENTALS OF PROCEDURE IN ACTIONS AT LAW* (1922) c. 1; Kuhn, *Local and Transitory Actions in Private International Law* (1918) 66 U. OF PA. L. REV. 301; Storke, *The Venue of Actions of Trespass to Land* (1921) 27 W. VA. L. Q. 301; Wicker, *Development of the Distinction between Local and Transitory Actions* (1926) 4 TENN. L. REV. 55. The principle local action remaining is trespass to land. *Doherty v. Catskill Cement Co.*, 72 N. J. L. 315, 65 Atl. 508 (1905); *Brit. So. Africa Co. v. Companhia de Moçambique*, [1893] A. C. 602. *Contra*: *Little v. Chicago, St. P., M. & O. Ry. Co.*, 65 Minn. 48, 67 N. W. 846 (1896).

4. For an excellent analysis of the problem see Foster, *Place of Trial in Civil Actions*

As a result of the increasing necessity for enlarging the number of forums available to the plaintiff, while at the same time maintaining such restrictions on his choice as not unduly to burden the defendant, both courts and legislatures have been compelled to create distinctions inexplicable in terms of the old dogma. This subservience of logic to practical considerations precludes an approach to the problem of interstate adjustment of the place of trial on a purely theoretical plane. An adequate appreciation of the progress that has been made toward its solution demands rather an analysis of the practical devices which have been developed in order to control the determination of the state of forum, the effectiveness of such devices, and the extent to which they have been utilized. The function of the legislatures in this process has been largely the broadening of the plaintiff's choice of forums through the introduction of new methods of acquiring jurisdiction, while the courts have construed the constitutional limitations applicable to these statutes in such manner as to realize their maximum potentialities when an extension of the plaintiff's choice of forums seemed desirable, and to circumvent or nullify them when due regard for the defendant's interests militated against such a result. The leading rôle in this judicial practice has been played by the "due process of law" formula, recently complemented by the introduction of the formula of "undue burden on interstate commerce,"<sup>5</sup> while additional flexibility has been attained by the development of such non-constitutional devices as the injunction and the courts' discretionary powers.

The constitutional devices can be discussed most conveniently according to the type of personality of the defendant—whether individual, partnership, unincorporated association, or corporation—at least where the action is based on jurisdiction over the defendant's person rather than his property.<sup>6</sup> Although thus far the commerce clause has been applied in this connection only to corporations, the due process formula is applied throughout, but with varying results, dependent largely upon the nature of the defendant.

#### ACTIONS AGAINST INDIVIDUALS

*Jurisdiction Based on Domicil.* At an early date the plaintiff's choice of forums was widened by statutes permitting substituted service at the defendant's domicil or, frequently, personal service on the defendant without the state, where the defendant was domiciled in the state, but temporarily resident

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(1930) 43 HARV. L. REV. 1217; *Place of Trial—Interstate Application of Intrastate Methods of Adjustment* (1930) 44 id. 41.

5. Also involved in the process of adjustment are the equal protection, privileges and immunities, and full faith and credit clauses.

6. Of the three prerequisites of a valid decree or judgment—jurisdiction over the person or property, jurisdiction over the subject matter, and venue—the first has provided by far the greatest degree of flexibility. The question of jurisdiction over the subject matter seldom arises in state courts of general jurisdiction. And venue is of value as an interstate adjuster only in the occasional action which is of such doubtful character that it may be held either local or transitory as the equities of the particular case demand. *Stone v. United States*, 167 U. S. 178 (1897) (action to recover value of timber taken from public lands held transitory, not trespass to land); *Ariz. Commercial Mining Co. v. Iron Cap Copper Co.*, 236 Mass. 185, 128 N. E. 4 (1920) (conversion of ore, traditionally transitory action, held local).

elsewhere. Since domicile as a basis of jurisdiction is a continental concept entirely foreign to the common law,<sup>7</sup> the constitutionality of such statutes under the due process clause cannot be definitely assured in the absence of a Supreme Court ruling. The only case in point ever to come before the Court may be said to approve such statutes only by negative implication,<sup>8</sup> but the weight of authority in other courts is clearly in favor of their validity.<sup>9</sup> Even though domicile be recognized as a proper basis of jurisdiction, however, due process of law further requires that the defendant receive the best possible notice and opportunity to defend under the circumstances.<sup>10</sup> Therefore, a defendant who can be found physically present within the jurisdiction must be personally served; but if he is domiciled in the state and cannot be found therein, the due process requirement is satisfied by substituted service at his domicile or by personal service without the state or possibly even by publication.<sup>11</sup> While reasonable notice alone is never a substitute for jurisdiction, jurisdiction in such cases is no longer predicated on physical power, but on domicile.<sup>12</sup>

*Nonresident Motorist Statutes.* The problem presented by the transient motorist who frequently leaves the *locus delicti* before he can be served with process has produced a new type of legislation.<sup>13</sup> As a result of a series of Supreme Court decisions upholding increasingly liberal nonresident motorist statutes it is now settled that a state may provide that every nonresident motorist, upon arrival in the state, shall be deemed automatically to have appointed a definite state official his agent to receive service of process in connection with all actions arising out of his use of the state roads,<sup>14</sup> but here

7. It is the basis of the civil law doctrine *actor sequitur forum rei*. See Perroud, *Principes de Compétence pour les Procès entre Etrangers* (1927) 54 JOUR. DU DR. INT. 561; Pillet, *Jurisdiction in Actions between Foreigners* (1905) 18 HARV. L. REV. 325. But the civil law, like the common law, has developed numerous exceptions. See Lorenzen, *French Rules of Conflict of Laws* (1927) 36 YALE L. J. 731, 742-747; WEISS, *MANUEL DE DROIT INTERNATIONAL PRIVÉ* (9th ed. 1925) 660 et seq.

8. *McDonald v. Mabee*, 243 U. S. 90 (1917).

9. *Douglas v. Forrest*, 4 Bing. 686 (C. P. 1828); *Continental Nat. Bank of Boston v. Thurber*, 74 Hun 632, 26 N. Y. Supp. 956 (Sup. Ct. 1893); *In re Hendrickson*, 40 S. D. 211, 167 N. W. 172 (1918); *RESTATEMENT, CONFLICT OF LAWS* (1934) §§ 47(1b), 79, hereafter referred to as *RESTATEMENT*; see *Knowles v. Gaslight & Coke Co.*, 19 Wall. 58, 61 (U. S. 1873); *Grover & Baker Mach. Co. v. Radcliffe*, 137 U. S. 287, 297 (1890). But cf. *Raher v. Raher*, 150 Iowa 511, 129 N. W. 494 (1911), 35 L. R. A. (N. S.) 292 (1912). See *Comments* (1911) 11 COL. L. REV. 352; (1917) 26 YALE L. J. 492; *Notes* (1901) 50 L. R. A. 577, 585; L. R. A. 1917C, 1143.

10. *McDonald v. Mabee*, 243 U. S. 90 (1917).

11. Service by publication has been upheld. *Henderson v. Staniford*, 105 Mass. 504 (1870); *Martin v. Burns*, 80 Tex. 676, 16 S. W. 1072 (1891); see note 57, *infra*; see *Note* (1912) 35 L. R. A. (N. S.) 292, 294. *Contra*: *De La Montanya v. De La Montanya*, 112 Cal. 101, 44 Pac. 345 (1896).

12. Cf. *Blackmer v. United States*, 284 U. S. 421 (1932) (jurisdiction of federal court based on allegiance).

13. See Culp, *Process in Actions Against Non-Resident Motorists* (1934) 32 MICH. L. REV. 325; Scott, *Jurisdiction over Nonresident Motorists* (1926) 39 HARV. L. REV. 563; *Comment* (1928) 14 ST. LOUIS L. REV. 62.

14. *Hendrick v. Maryland*, 235 U. S. 610 (1915); *Kane v. New Jersey*, 242 U. S. 160

again the requirements of due process must be satisfied by a provision in the statute for adequate notice to the defendant.<sup>15</sup> Such statutes are now general, and they offer the plaintiff a material advantage even where the defendant has no property in the state on which execution can be levied, for an action can be brought on the judgment in the state of the defendant's residence, under the full faith and credit clause, without the necessity of transportation of the witnesses who are required in the original action. The courts, moreover, in construing these statutes, have rendered them available to the nonresident plaintiff as well as the resident,<sup>16</sup> even where he and the defendant are residents of the same state,<sup>17</sup> although they have stopped short generally at construing the word "operate" in the statutes as applicable to acts of servants or employees of the defendant owner, unless the statute plainly requires such application.<sup>18</sup>

*Jurisdiction over Nonresident Individuals Doing Business in the State.* In the recent case of *Henry L. Doherty and Company v. Goodman*,<sup>19</sup> the Supreme Court extended the doctrine of the nonresident motorist cases to the realm of economic activity, upholding an Iowa judgment of damages for an illegal sale of stock obtained against an individual who was a resident of New York trading in corporate securities in Iowa, solely through agents, under the name of Henry L. Doherty and Company. Although the defendant, in compliance with the local "Blue Sky Law,"<sup>20</sup> had registered and filed a written consent to service of process upon the Secretary of State as his agent, service was had upon the agent in charge of the defendant's business in the state under an old general statute providing for service upon an agent or clerk of any "corporation, company or individual" having "an office or agency in any county other than that in which the principal resides . . . in all actions growing out of or connected with the business of that office or agency."<sup>21</sup>

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(1916), noted in (1917) 26 YALE L. J. 422; *Hess v. Pawlowski*, 274 U. S. 352 (1927). See Meleski, *Case of Hess v. Pawlowski* (1927) 7 B. U. L. REV. 243.

15. Actual notice, moreover, will not cure the absence of such a provision. *Wuchter v. Pizzutti*, 276 U. S. 13, 57 A. L. R. 1239 (1928); see Comment (1936) 22 VA. L. REV. 477. But service is not invalidated by the defendant's refusal to sign a receipt required by the statute. *Creadick v. Keeler*, 35 Del. 169, 160 Atl. 909 (Super. Ct. 1932). And there need be no provision for notice in those statutes requiring an express appointment of a process agent. *Kane v. New Jersey*, 242 U. S. 160 (1916); see *Wuchter v. Pizzutti*, *supra*, at 19.

16. *Garon v. Poirier*, 86 N. H. 174, 164 Atl. 765 (1933).

17. *State ex rel. Rush v. Circuit Ct.*, 209 Wis. 246, 244 N. W. 766 (1932).

18. *Morrow v. Asher*, 55 F. (2d) 365 (N. D. Tex. 1932); cf. *Young v. Potter Title & Trust Co.*, 114 N. J. L. 561, 178 Atl. 177 (Sup. Ct. 1935), noted in (1935) 49 HARV. L. REV. 145 (statute inapplicable to foreign executor of nonresident motorist killed in accident); see Comment (1930) 78 U. OF PA. L. REV. 771; (1932) 80 id. 909. But there would seem to be no constitutional objection to a different construction. *Poti v. New Eng. Road Mach'y Co.*, 83 N. H. 232, 140 Atl. 587 (1928); cf. *Doherty & Co. v. Goodman*, 294 U. S. 623 (1935). The driver's being engaged in interstate commerce does not save him from substituted service. *Sweet v. Miller*, 147 Misc. 806, 264 N. Y. Supp. 565 (Sup. Ct. 1933).

19. 294 U. S. 623 (1935), noted in (1935) 48 HARV. L. REV. 1433, (1935) 33 MICH. L. REV. 963, (1935) 13 N. Y. U. L. Q. REV. 113, (1935) 83 U. OF PA. L. REV. 921. The case is hereafter referred to as the *Goodman* case.

20. IOWA CODE (1935) § 8581-c9.

21. *Id.* § 11,079. It is doubtful whether a statute would be upheld which subjected

The decision was not unheralded, for similar broad statutes exist in at least eight states<sup>22</sup> and they have given rise to like decisions in the state courts,<sup>23</sup> notwithstanding the contention sometimes made that they pertain only to venue within the state and are not jurisdictional in aspect. But the implications of the case are not clear. The Supreme Court, in *Flexner v. Farson*,<sup>24</sup> had denied the validity, under the due process clause, of a judgment obtained against non-residents who were doing business in the state as partners, where service was had upon their agent under a Kentucky statute. That case was distinguished in the *Goodman* case upon the ground that the person served in the former case was no longer the defendants' agent. The latter fact, however, was buried in the pleadings of the *Flexner* case; the decision there was based squarely upon the state's disability, under the privileges and immunities clause, entirely to exclude nonresident partners and hence to condition their admission upon their consenting to substituted service upon an agent. Consequently, the *Flexner* case appears to have been effectively overruled, and, although Mr. Justice McReynolds, in the *Goodman* opinion, carefully warned against the decision's being extended beyond the circumstances of the particular case, there would seem to be no logical obstacle to an expansion of its doctrine to cover any sort of business conducted by a nonresident in the state.<sup>25</sup>

Yet, logic here, as in other phases of the problem of interstate adjustment, is apt to be subordinated to practical considerations of reasonableness, and if it is deemed desirable not to extend the decision of the *Goodman* case beyond its facts, it can be distinguished simply on the ground of the peculiar nature of the securities business, a factor which the opinion stressed despite the fact that service was had upon the defendant's managing agent under the general statute and not upon the Secretary of State under the "Blue Sky Law."<sup>26</sup> Even

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nonresident individuals doing business in the state to suit on causes of action arising in other states, although the logic of such a distinction is questionable. See notes 44, 67, *infra*.

22. See Culp, *Process in Actions against Non-Residents Doing Business within a State* (1934) 32 MICH. L. REV. 909; Daum, *The Transaction of Business within a State by a Non-Resident as a Foundation for Jurisdiction* (1934) 19 IOWA L. REV. 421, 422, n. 5; Barry, *Jurisdiction over Non-Residents* (1927) 13 VA. L. REV. 175; Horne, *Advantages of a Non-Resident Conducting an Unincorporated Business in Illinois* (1919) 14 ILL. L. REV. 189; Scott, *Jurisdiction over Nonresidents Doing Business within a State* (1919) 32 HARV. L. REV. 871.

23. *Davidson v. Doherty & Co.*, 214 Iowa 739, 241 N. W. 700 (1932), 91 A. L. R. 1327 (1934) (four judges dissenting), noted in (1932) 46 HARV. L. REV. 153; *Stoner v. Higginson & Co.*, 316 Pa. 481, 175 Atl. 527 (1934), noted in (1935) 83 U. OF PA. L. REV. 683 (non-resident partners); see Comments (1935) 1 IOWA B. REV. 53; (1933) 18 IOWA L. REV. 257; (1932) 18 VA. L. REV. 896.

24. 248 U. S. 289 (1919).

25. See RESTATEMENT § 84. The English practice allows service, by leave of the court, on a local agent of a nonresident principal, with respect to actions arising out of contracts made by such agent within the jurisdiction, notice being sent to the principal abroad by prepaid registered letter. ANNUAL PRACTICE, RULES OF THE SUPREME COURT (1935) Order 9, r. 8a; cf. Order 11, r. 1; see DICEY, CONFLICT OF LAWS (15th ed. 1932) 233; Sunderland, *The Problem of Jurisdiction* (1926) 4 TEX. L. REV. 429; Keasbey, *Jurisdiction over Non-Residents in Personal Actions* (1905) 5 COL. L. REV. 436.

26. The special nature of the defendant's business, however, was not discussed by the

so limited, however, the rule of the *Goodman* case would seem applicable at least to any business similarly amenable to the state's extensive regulatory powers.<sup>27</sup>

#### ACTIONS AGAINST JOINT DEBTORS AND PARTNERS

The physical power concept left the plaintiff completely helpless in the case of defendants who were liable only jointly, when one or more were outside the jurisdiction.<sup>28</sup> And his burden was not alleviated when the joint debtors were partners, at least prior to the *Goodman* case, for, by the great weight of authority, a partnership was not regarded at common law as an entity suable in the firm name,<sup>29</sup> nor, under the rule in *Flexner v. Farson*,<sup>30</sup> could a valid personal judgment be obtained against the absent partners individually by service on their local agent without their consent, even though they were doing business

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Iowa court, either in its opinion in *Goodman v. Doherty & Co.*, 218 Iowa 529, 255 N. W. 667 (1934), or in its opinion in the earlier case of *Davidson v. Doherty & Co.*, 214 Iowa 739, 241 N. W. 700 (1932), from which the Supreme Court liberally quoted in the *Goodman* case. Furthermore, since there was apparently never any attempt to apply the second statute, it is problematical whether it was mentioned by the Supreme Court merely to reinforce its point of Iowa's treatment of the securities business as exceptional or whether in some future case the court will grasp upon this additional fact to distinguish the *Goodman* case, as in the *Goodman* case itself it resorted to an obscure pleading in order to distinguish the indistinguishable *Flexner* case.

27. Cf. *La Tourette v. McMaster*, 248 U. S. 465 (1919) (insurance agents); *Nebbia v. New York*, 291 U. S. 502 (1934) (milk business).

28. See Note (1901) 50 L. R. A. 577, 595. If the absent debtor or debtors, however, were domiciled in the state, there would seem to be no objection to proceeding to a joint judgment, even though jurisdiction as to some would be based on physical presence and as to others on domicile, for there would, nevertheless, be personal jurisdiction over all. Cf. *Martin v. Burns*, 80 Tex. 676, 16 S. W. 1072 (1891).

29. *Dunham v. Shindler & Co.*, 17 Ore. 256, 20 Pac. 326 (1889). *Contra*: *Johnston v. Mathews*, 32 Md. 363 (1869); *Walsh v. Kirby*, 228 Pa. 194, 77 Atl. 452 (1910). Although these latter cases preceded *Flexner v. Farson*, 248 U. S. 289 (1919), cited note 30, *infra*, they are not necessarily in conflict, since they involve judgments good only against the firm assets and not against the partners individually who were not served. See note 35, *infra*. It has also been held that any defect by reason of the action's being brought against the firm is waived by a defense on the merits. *Anglo-American Packing & Prov. Co. v. Turner Casing Co.*, 34 Kan. 340, 8 Pac. 403 (1885). And one partner may have authority to employ an attorney to enter an appearance for his copartners. *Henck v. Barnes*, 84 Hun 546, 32 N. Y. Supp. 840 (Sup. Ct. 1895). But cf. *Hall v. Lanning*, 91 U. S. 160, 166 (1875). Such an attorney may confess judgment against the firm. *Lahey v. Kingon*, 13 Abb. Pr. 192 (N. Y. Sup. Ct. 1861). But cf. *Dixonville Deposit Bank v. Marshall Federal Bakery*, 102 Pa. Super. 308, 156 Atl. 629 (1931). A confession of judgment by one partner in advance of suit binds only his individual property and his interest in the firm assets. UNIFORM PARTNERSHIP ACT § 9 (3); *VanScoten v. Botsford & Kunes*, 98 Pa. Super. 270 (1930); see *Hall v. Lanning*, *supra*, at 170. But cf. *Walsh v. Kirby*, *supra*.

30. 248 U. S. 289 (1919); *Conville v. Dun & Co.*, 153 La. 1073, 97 So. 197 (1923) (although a partnership is a distinct entity in the civil law). *Contra*: *Stoner v. Higginson & Co.*, 316 Pa. 481, 175 Atl. 527 (1934), noted in (1935) 83 U. OF PA. L. REV. 683. See *Hol- doegel, Jurisdiction over Partnerships, Non-Partnership Associations, and Joint Debtors* (1926) 11 IOWA L. REV. 193; *Magruder & Foster, Jurisdiction over Partnerships* (1924) 37 HARV. L. REV. 793.

in the state. The plaintiff's only remedy at common law was outlawry of the absent or absconding debtor, but this drastic procedure was never adopted in the colonies. Instead several statutory remedies were created. Some states adopted the simple expedient of declaring that all joint obligations should be deemed joint and several for purposes of suit, thus allowing an action to be brought for the full amount of the claim against the debtor or debtors over whom jurisdiction can be obtained.<sup>31</sup> Others passed joint debtor acts, under which a joint judgment may be secured by service upon the debtor or debtors within the state, execution being necessarily limited, however, in conformity with the due process clause, to the joint property of the defendants and the separate property of the debtor or debtors served.<sup>32</sup>

These statutes are generally held to include partnership obligations, some providing so expressly. A third type of statute, however, created specifically to meet the partnership problem, subjects partnerships doing business in the state to suits in the firm name with respect to causes of action arising out of such business, and limits execution on judgments so obtained to the assets of the firm and of any individual partner or partners served.<sup>33</sup> This type of statute is thus quite similar to the joint debtor type in results,<sup>34</sup> but the former offers partnership creditors several advantages over the latter.<sup>35</sup> The most important is that the partnership acts permit a judgment against the firm, so long as the cause of action has arisen out of business done by it in the state, even when all the partners are nonresident, through service on a local agent,<sup>36</sup> whereas the joint debtor acts require service on at least one of the individual defendants. Moreover, although there is some question of the possibility of levying against the joint property, under the joint debtor acts, in an action on the original judgment in another jurisdiction,<sup>37</sup> a judgment rendered against

31. ROWLEY, *MODERN LAW OF PARTNERSHIP* (1916) §§ 495, 496.

32. *Blessing v. McLinden*, 81 N. J. L. 379, 79 Atl. 347 (1911).

33. RESTATEMENT § 86 (1). For lists of statutes, see 1 BEALE, *CONFLICT OF LAWS* (1935) § 86.1; WARREN, *CORPORATE ADVANTAGES WITHOUT INCORPORATION* (1929) bk. 1, c. 3. Some statutes limit execution only to firm assets; and the partnership statutes are generally not limited to contract actions, as are the joint debtor acts.

34. Both types of statutes are valid so far as they bind the defendant or defendants served. *Renaud v. Abbott*, 116 U. S. 277 (1886). And they are invalid to the extent that they purport to bind individually joint debtors or partners not served. *D'Arcy v. Ketchum*, 11 How. 165 (U. S. 1850).

35. There might be a due process objection to depriving a nonresident joint debtor of his undivided interest in the joint property. See *Tay v. Hawley*, 39 Cal. 93, 96 (1870); cf. *Mason v. Denison*, 15 Wend. 64, 67 (N. Y. Ct. Err. 1835); see FREEMAN, *JUDGMENTS* (4th ed. 1892) § 120a. But cf. *Brooks v. McIntyre*, 4 Mich. 316 (1856). But the objection to holding the firm property seems to disappear under the partnership acts. *Sugg v. Thornton*, 132 U. S. 524 (1889); *Esteve Bros. & Co. v. Harrell*, 272 Fed. 382 (C. C. A. 5th, 1921). This has been pointed to as "a tacit . . . adherence to the conception of the firm as an entity." See *Magruder & Foster*, *supra* note 30, at 804. *Contra*: See WARREN, *loc. cit. supra* note 33.

36. *Esteve Bros. & Co. v. Harrell*, 272 Fed. 382 (C. C. A. 5th, 1921) (all the partners aliens).

37. *Hoffman v. Wight*, 1 App. Div. 514, 37 N. Y. Supp. 262 (1st Dep't, 1896); see 1 BEALE, *op. cit. supra* note 33, § 86.3. Doctrinally, however, it would seem that the joint property should be bound wherever situated, for the action is *in personam* and not based upon an attachment of the specific property in the state of suit.

the partnership is a binding adjudication of the firm's liability with respect to its assets situated in any other state.<sup>38</sup> This result is not precluded by the fact that the partnership is not subject to suit in the firm name in the state where the property sought to be reached is located.<sup>39</sup> The action on the judgment is merely maintained against the partners individually in the second state and the judgment against the firm is recognized as conclusive of the liability of the several partners served to the extent of their respective interests in the firm property.<sup>40</sup> A judgment obtained under either type of statute does not, according to the better view, operate as a merger of the entire cause and a bar to a subsequent action for any uncollected portion of the judgment against the individual debtors or partners not served.<sup>41</sup>

The firm name statutes do not exclude the common law action against all the partners jointly.<sup>42</sup> The latter type of action is, of course, preferable when jurisdiction can be obtained over all of them, for it results in a judgment on which execution is not limited by the due process clause to firm property or the property of certain members, as it is under both joint debtor and firm name acts. It would seem, moreover, that such a judgment could now be obtained even against nonresident partners, under the doctrine of the *Goodman* case.<sup>43</sup> But until the Supreme Court expressly overrules *Flexner v. Farson*<sup>40</sup> and further delineates the *Goodman* doctrine, the prudent plaintiff will probably satisfy himself with the possibly less complete, but more certain, statutory remedies.<sup>44</sup>

38. *East Denver Municipal Irrigation Dist. v. Doherty*, 293 Fed. 804 (S. D. N. Y. 1923); RESTATEMENT § 86(2).

39. Since rules of procedure follow the law of the forum, the remedy of the first state is not available in the second. *Edwards v. Warren Linoline & Gasoline Works, Ltd.*, 168 Mass. 564, 47 N. E. 502 (1897) (Pa. "partnership ass'n"); cf. *Taft v. Ward*, 106 Mass. 518 (1871) (N. Y. joint stock co.). But cf. *Edgeworth v. Wood*, 58 N. J. L. 463, 33 Atl. 940 (Sup. Ct. 1896) (same).

40. *East Denver Municipal Irrigation Dist. v. Doherty*, 293 Fed. 804 (S. D. N. Y. 1923); RESTATEMENT § 86(2), com. b.; cf. *Sistare v. Sistare*, 218 U. S. 1 (1910).

41. There is said to be a conflict on this point. See BRIGLOW, ESTOPPEL (5th ed. 1890) 104-112. But it can be resolved. The general rule at common law is that a judgment on a joint action bars the entire cause. *Parr v. Snell*, [1923] 1 K. B. 1 (Ct. App.); Note (1919) 1 A. L. R. 1601. But an exception has grown up under the joint debtor acts, on the ground that the plaintiff had no choice but to omit some of the debtors in his original action. *Olcott v. Little*, 9 N. H. 259 (1838); *Crehan v. Megarel*, 234 N. Y. 67, 136 N. E. 296 (1922). *Contra*: see *Mason v. Eldred*, 6 Wall. 231, 238 (U. S. 1867). Many states have statutes expressly changing the common law rule. *Mason v. Eldred*, *supra*; *WARREN*, loc. cit. *supra* note 33.

42. *Peabody v. Oleson*, 15 Colo. App. 346, 62 Pac. 234 (1900).

43. RESTATEMENT § 86(2), com. c. The *Goodman* case, however, would seem inapplicable to nonresident joint debtors who are not partners, for they can hardly be said to be "doing business" in the state in the sense that an individual or partnership or corporation does. See note 60, *infra*.

44. The plaintiff should be able to join a common law action with an action against the firm under the codes. See note 54, *infra*. There is a further question as to the prerequisites of the applicability of the firm name acts. This is virtually a virgin field, but the analogy of actions against foreign corporations would seem generally applicable. See *Magruder & Foster*, *supra* note 30, at 828.

## ACTIONS AGAINST UNINCORPORATED ASSOCIATIONS

There appears to be a lacuna in established legal doctrine with respect to actions against the various sorts of combinations intermediate between co-partnerships and formal corporations. These associations range in type from such quasi-corporate groups as joint stock companies and business trusts, which are governed at common law by the same principles applicable to partnerships,<sup>45</sup> to such non-profit groups as labor unions, fraternal and religious bodies and boards of trade, whose status at common law seems never to have been clearly defined. Nevertheless, the common law exhibited the same hostility toward considering any of them entities as it did with respect to simple partnerships,<sup>46</sup> with the more serious result in the case of associations, however, that the plaintiff, often finding it practically impossible to join all of the many individual members, was left completely remediless. Equity mitigated this hardship to a certain extent by developing the class suit, which lay against representative members of the group,<sup>47</sup> but there was no clear-cut departure from

45. See *Sutherland v. United States*, 74 F. (2d) 89, 93 (C. C. A. 8th, 1934).

46. *Tyler v. Boot & Shoe Workers' Union*, 285 Mass. 54, 188 N. E. 509 (1933); *Beaumont v. Meredith*, 3 Ves. & B. 180 (Ch. 1814). But, practically, the rule against an association's being a party to an action was evaded in a number of important respects, through the doctrine of waiver. See *Dodd, Dogma and Practice in the Law of Associations* (1929) 42 HARV. L. REV. 977, 1000. And in several cases the fact that a trade union was made a party defendant seemed to be ignored. *Southern Ry. Co. v. Machinists' Local Union*, 111 Fed. 49 (C. C. W. D. Tenn. 1901); *Vegeahn v. Guntner*, 167 Mass. 92, 44 N. E. 1077 (1896); *Barr v. Essex Trades Council*, 53 N. J. Eq. 101, 30 Atl. 881 (Ch. 1894). Suit in the association name, moreover, has been allowed without statute, on the analogy of the class suit (see note 47, *infra*). *Liederkrantz Singing Soc. v. Germania Turn-Verein*, 163 Pa. 265, 29 Atl. 918 (1894). See generally *Jardine v. Superior Ct.*, 213 Cal. 301, 2 P. (2d) 756 (1931), 79 A. L. R. 305 (1932); *Holdoegel, supra* note 30; *Laski, Personality of Associations* (1916) 29 HARV. L. REV. 404; *Sturges, Unincorporated Associations as Parties to Actions* (1924) 33 YALE L. J. 383; *WARREN, op. cit. supra* note 33; *Comment* (1919) 33 HARV. L. REV. 298.

47. *Beatty v. Kurtz*, 2 Pet. 566 (U. S. 1829); *Smith v. Swarmstedt*, 16 How. 288 (U. S. 1853); *Harger v. Barrett*, 319 Mo. 635, 5 S. W. (2d) 1100 (1928). A decree so obtained bars a subsequent action on the same subject matter by the parties represented. *Amer. Percheron Horse Breeders' Ass'n v. Amer. Percheron Horse Breeders' & Importers' Ass'n*, 114 Ill. App. 136 (1904). The class suit is now largely statutory. The codes, merging law and equity, extend the doctrine to actions at law, generally providing that when the question is one of common or general interest to many persons constituting a class so numerous as to make it impracticable to bring them all before the court, one or more may sue or defend for all. There is thus open to both plaintiff and defendant a valuable device which is applicable not only to members of unincorporated associations, but to creditors, stockholders, bondholders, taxpayers and other groups as well. Yet so commonplace has it become that there seems to be no concern about the fact that it may result in a binding adjudication of the rights of persons, either as plaintiffs or as defendants, who are in no way subject to the jurisdiction of the court. *Supreme Tribe of Ben-Hur v. Cauble*, 255 U. S. 356 (1921), noted in (1921) 21 COL. L. REV. 487. As to stockholders' suits, see authorities collected in *Comment* (1936) 45 YALE L. J. 649, 665. As to creditors' bills, see *Glenn, The Uniform Fraudulent Conveyance Act; Rights of Creditors without Judgment* (1930) 30 COL. L. REV. 202. See generally *Blume, The "Common Questions" Principle in the Code Provision for Representative Suits* (1932) 30 MICH. L. REV. 878; *Wheaton, Representative Suits Involv-*

the common law doctrine until the comparatively recent *Coronado Coal* case,<sup>48</sup> where the Supreme Court, following the English *Taff Vale Railway Company* case,<sup>49</sup> held that an unincorporated labor union could be sued as such in the federal courts.

Aside from the debatable socio-economic controversy there involved, the *Coronado Coal* case may be said to indicate a realistic view of the procedural problem presented by the huge unincorporated associations of today, whose membership is frequently nation-wide and whose activities are unconfined by state boundaries. Nevertheless, until the state courts generally recognize the suability of associations generally at common law, the plaintiff must depend, as in partnership cases where the common law remedy of joinder of all the members is unavailable, upon the various statutory remedies which have been devised with the view both of finding him a ready defendant and of widening the number of forums in which such a defendant can be made to respond. The extent to which the several statutory remedies against partners apply to the various unincorporated associations is simply a matter of statutory construction.<sup>50</sup> A number of states, however, have considered such associations sufficiently distinctive<sup>51</sup> to warrant separate statutory treatment, and they have provided for suits by and against these groups, in the name of the association or of an officer thereof, with respect to causes of action arising out of business done by them in the state of suit.<sup>52</sup> The Supreme Court, moreover, has upheld

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*ing Numerous Litigants* (1934) 19 CORN. L. Q. 399; Comments (1934) 34 COL. L. REV. 118; (1934) 19 CORN. L. Q. 614; (1922) 36 HARV. L. REV. 89; cf. Chaffee, *Bills of Peace with Multiple Parties* (1932) 45 HARV. L. REV. 1297.

48. *United Mine Workers of America v. Coronado Coal Co.*, 259 U. S. 344 (1922), 27 A. L. R. 786 (1923); see WARREN, op. cit. *supra* note 33, bk. 2, c. 9; Magill & Magill, *The Suability of Labor Unions* (1922) 1 N. C. L. REV. 81. This case, however, arose on a federal question; the federal courts still refuse to recognize unincorporated associations as having a citizenship distinct from that of its members for purposes of diversity jurisdiction. *Levering & Garrigues Co. v. Morrin*, 61 F. (2d) 115 (C. C. A. 2d, 1932), noted in (1933) 33 COL. L. REV. 363, aff'd on another point, 289 U. S. 103 (1933) (labor union); *Chapman v. Barney*, 129 U. S. 677 (1889) (N. Y. joint stock co.); *Great So. Fire Proof Hotel Co. v. Jones*, 177 U. S. 449 (1889) (Pa. "partnership ass'n"); *Thomas v. Bd. of Trustees of Ohio State Univ.*, 195 U. S. 207 (1904) (board of trustees); *McLaughlin Bros. v. Hallowell*, 228 U. S. 278 (1913) (partnership suable in the firm name).

49. *Taff Vale Ry. Co. v. Amalgamated Soc. of Ry. Servants*, [1901] A. C. 426, 1 B. R. C. 832 (1911); cf. Notes (1927) 61 IR. L. J. 10, 97. This decision led to the Trade Disputes Act, 6 Edw. VII, c. 47 (1906), whereby trade unions are no longer subject to suit in tort.

50. *Johnston v. Albritton*, 134 So. 563 (Fla. 1931) (firm name statute held inapplicable). The converse is also true. In *re Grossmayer*, 177 U. S. 48 (1900) (Tex. ass'n statute held inapplicable to partnership).

51. *Laycock v. State*, 136 Ind. 217, 36 N. E. 137 (1894) (trade union); *Ash v. Guie*, 97 Pa. 493 (1881) (fraternity).

52. *Jardine v. Superior Ct.*, 213 Cal. 301, 2 P. (2d) 756 (1931) (stock exchange); *State ex rel. Rr. & Warehouse Comm. v. Adams Exp. Co.*, 66 Minn. 271, 68 N. W. 1035 (1896) (N. Y. joint stock co.). The statutes vary greatly. Sometimes associations are lumped with partnerships, while even broader statutes are not infrequent (see note 21, *supra*). On the other hand, some statutes apply only to certain types of associations, like business trusts. MASS. ANN. LAWS (Lawyer's Co-op., 1933) c. 182, § 6; OKLA. STAT. ANN. (Harlow, 1931)

a state statute compelling a common law trust, in the same manner as a corporation, to appoint a process agent as a condition of its doing business in the state.<sup>53</sup> This decision would seem to give the states free rein to determine when an unincorporated group of nonresident individuals shall be treated as a foreign corporation for purposes of suit, at least when the association has in fact all the corporate characteristics. But the doctrine of the *Goodman* case, permitting service on any local managing agent and thus rendering an express authorization to receive process unessential, may obviate the necessity of thus assimilating all unincorporated groups to formal corporations as a prerequisite of subjecting them to suits in states other than those of their organization or principal headquarters.

These statutes, of course, are merely procedural in scope. They in no wise enlarge the substantive liability of the individual members of the association.<sup>54</sup> Thus, in order to secure a judgment against the association, the plaintiff must show that all the members might have been sued jointly,<sup>55</sup> and even then execution is generally limited by the statute to the association property, although there would seem to be no due process objection to rendering also liable the assets of the member or members actually served, on the analogy of the joint debtor and partnership statutes.<sup>56</sup>

#### ACTIONS AGAINST FOREIGN CORPORATIONS

When the plaintiff is suing a corporation, his problem is not primarily one

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§§ 182a-182b; Wis. STAT. (1931) § 226.14(11); see Note (1927) 46 A. L. R. 169, 185. For lists of statutes, see Culp, *supra* note 22, at 909, n. 3; Holdoegel, *supra* note 30, at 215, n. 118; WARNER, *loc. cit. supra* note 33. See note 39, *supra*. Non-profit associations can hardly be said to be "doing business," but there is no objection to their coming within general association statutes so long as they are engaged in the state in their regular activities. *Jardine v. Superior Ct.*, *supra*. *Contra*: *St. Paul Typotheta v. St. Paul Bookbinders' Union*, 94 Minn. 351, 102 N. W. 725 (1905) (labor union). But cf. *Fitzpatrick v. Int'l Typographical Union*, 149 Minn. 401, 184 N. W. 17 (1921).

53. *Hemphill v. Orloff*, 277 U. S. 537 (1928); cf. *Liverpool Ins. Co. v. Massachusetts*, 10 Wall. 566 (U. S. 1870) (Eng. joint stock co. admissible into state only on paying tax). See Dodd, *supra* note 46, at 989.

54. Nor do they exclude the common law action against the associates severally or jointly, according to their substantive liability. *Davison v. Holden*, 55 Conn. 103, 10 Atl. 515 (1887). In the case of business trusts, the trustee is still personally liable unless there is an agreement by the plaintiff to look only to the trust property. *Larson v. Sylvester*, 282 Mass. 352, 185 N. E. 44 (1933). As in the case of partnerships (see note 44, *supra*), the plaintiff might be able under the codes to join the common law action with the statutory action. *Detroit Light Guard Band v. First Mich. Indep. Infantry*, 134 Mich. 598, 96 N. W. 934 (1903). *Contra*: N. Y. GEN. ASS'NS LAW (1921) § 13; *Mandell v. Moses*, 209 App. Div. 531, 205 N. Y. Supp. 254 (3d Dep't, 1924).

55. *McCabe v. Goodfellow*, 133 N. Y. 89, 30 N. E. 728, 17 L. R. A. 204 (1892) ("Law and Order League"); *Schouten v. Alpine*, 215 N. Y. 225, 109 N. E. 244 (1915) (labor union). But the court will not inquire on a motion to dismiss in advance of trial whether joint liability does in fact exist. *Jardine v. Superior Ct.*, 213 Cal. 301, 2 P. (2d) 756 (1931).

56. Statutes have been upheld allowing execution on all the members individually, whether or not served, as well as the association. *Appeal of Baylor*, 93 S. C. 414, 77 S. E. 59 (1913); *Patch Mfg. Co. v. Capeless*, 79 Vt. 1, 63 Atl. 938 (1906); see Comment (1906) 20 HARV. L. REV. 58. These decisions, however, seem to be spurious. See WARREN, *op. cit. supra* note 33, at 553.

of finding a defendant to sue, as it is in the case of unincorporated associations, for a corporation, being a formally created artificial entity, can always be compelled to defend any action brought against it in the state of its charter.<sup>57</sup> Rather, his problem is one of the extent to which other courts are open to him. There has been no dearth of speculation to justify the assumption by state courts of jurisdiction over foreign corporations and reconcile the varying extent of such jurisdiction under different circumstances.<sup>58</sup> Yet in no phase of the problem of interstate adjustment of the place of trial have theoretical considerations been more pronouncedly subordinated to practical results through the use of the constitutional formulas as devices to secure flexibility.

*The Due Process Clause.* An outstanding example of such use is the fact that the courts have made it a first prerequisite to a valid personal judgment against a foreign corporation, in the absence of consent to be sued in a particular state, that the corporation be "doing business" in the state,<sup>59</sup> yet they have repeatedly refused to give the term any definition,<sup>60</sup> beyond holding that "single or isolated" transactions<sup>61</sup> within the state or "mere incidental activi-

57. Jurisdiction can be obtained over a domestic corporation by service on an officer outside the state, under the same principle which allows service without the state on an individual domiciled in the state (see note 9, *supra*). *Bennett v. Chicago Lumber & Coal Co.*, 201 Iowa 770, 208 N. W. 519 (1926). And service on a domestic corporation by publication may also suffice. *Ward Lumber Co. v. Henderson-White Mfg. Co.*, 107 Va. 626, 59 S. E. 476 (1907).

58. See 1 BEALE, *op. cit. supra* note 33, § 89.5 et seq.; BEALE, *THE LAW OF FOREIGN CORPORATIONS* (1904) cc. 7, 11; Bullington, *Jurisdiction over Foreign Corporations* (1928) 6 N. C. L. REV. 147; Cahill, *Jurisdiction over Foreign Corporations and Individuals Who Carry on Business within the Territory* (1917) 30 HARV. L. REV. 676; Farrier, *Jurisdiction over Foreign Corporations* (1933) 17 MINN. L. REV. 270; Fead, *Jurisdiction over Foreign Corporations* (1926) 24 MICH. L. REV. 633; Francis, *Domicil of a Corporation* (1929) 38 YALE L. J. 335; HENDERSON, *POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW* (1918) c. 5; Stimson, *Jurisdiction over Foreign Corporations* (1933) 18 ST. LOUIS L. REV. 195; also note 156, *infra*.

59. *Riverside & Dan River Cotton Mills v. Menefee*, 237 U. S. 189 (1915). The "doctrine of unconstitutional conditions," moreover, precludes the exaction of an involuntary consent to be used in the absence of the corporation's "doing business" in the state. With respect to this doctrine, see *Insurance Co. v. Morse*, 20 Wall. 445 (U. S. 1874); Hale, *Unconstitutional Conditions and Constitutional Rights* (1935) 35 COL. L. REV. 321; HENDERSON, *op. cit. supra* note 58, c. 8; Merrill, *Unconstitutional Conditions* (1929) 77 U. OF PA. L. REV. 879; Oppenheim, *Unconstitutional Conditions and State Powers* (1927) 26 MICH. L. REV. 176.

60. See *People's Tobacco Co., Ltd., v. Amer. Tobacco Co.*, 246 U. S. 79, 86 (1917); Isaacs, *An Analysis of Doing Business* (1927) 100 CENT. L. J. 177, 189; Osborne, "Arising out of Business Done in the State" (1923) 7 MINN. L. REV. 380; Rothschild, *Jurisdiction of Foreign Corporations in Personam* (1930) 17 VA. L. REV. 129.

61. *James-Dickinson Farm Mortgage Co. v. Harry*, 273 U. S. 119 (1927). But the rule is sometimes applied that the corporation may be sued on a cause of action arising out of such a single transaction. This probably explains the certain amount of confusion that has arisen as to whether the place of accrual of the cause of action affects the necessary quantum of doing business. See Note (1924) 30 A. L. R. 255, 292. Foreign corporations may come within the nonresident motorist statutes. *Wuchter v. Pizzutti*, 276 U. S. 13 (1928); *Poti v. New Eng. Road Mach'y Co.*, 83 N. H. 232, 140 Atl. 587 (1928).

ties<sup>62</sup> are insufficient.<sup>63</sup> This constant requirement satisfied, the extent of the plaintiff's power to sue a corporation elsewhere than in the state of its charter seems to depend upon the type of service by which the action is commenced.<sup>64</sup> The service statutes are of several types, but in general they give rise to three distinct situations.

(1) Statutes sometimes require the express appointment by a foreign corporation, as a prerequisite to doing business in the state, of some state official or regular corporate agent as its agent to receive service of process. So long as the terms of such an agent's appointment are as broad as the provisions of the statute, the question of the extent of his authority is clearly one of statutory construction, for there is no constitutional objection to a foreign corporation's expressly so consenting to be sued on causes of action arising anywhere, even though unconnected with any business done in the state of forum.<sup>65</sup>

(2) Where, however, there is no express consent to be sued, either because of the absence of a statute requiring such consent or failure of the corporation to comply with its provisions, the courts have become involved in difficulties with respect to the theoretical basis of jurisdiction, and their attempts

62. Michigan Cent. Ry. Co. v. Mix, 278 U. S. 492 (1928).

63. Yet the only exception to this requirement is that the corporation is liable to suit even after withdrawing from the state on causes of action accruing while it was still there, so long as there is a statute which can be construed to impose such liability. Hunter v. Mut. Reserve Life Ins. Co., 218 U. S. 573 (1910); Du Pont Engineering Co. v. Harvey Constr. Co., 156 Va. 811, 158 S. E. 891 (1931) (dissolved foreign corporation held suable for three years like domestic corporation). Doubt has been expressed as to the suability of foreign corporations after their withdrawal, when no service agent has been appointed and service is had by statute on a state official. Geer v. Mathieson Alkali-Works, 190 U. S. 428 (1903); see 1 BEALE, op. cit. *supra* note 33, § 93.1. But the doubt seems groundless, at least as to causes of action arising out of business formerly done by the corporation in the state (see note 66, *infra*). American Ry. Express Co. v. Royster Guano Co., 273 U. S. 274 (1927); Washington ex rel. Bond & Goodwin & Tucker, Inc., v. Superior Ct., 289 U. S. 361 (1933); see Scott, *supra* note 13, at 578. But cf. Golden v. Connersville Wheel Co., 252 Fed. 904 (E. D. Mich. 1918). It has been held that withdrawal is effective immediately with respect to actions arising out of interstate commerce. Guerin Mills v. Barrett, 254 N. Y. 380, 173 N. E. 553 (1930). See Collier, *Revocation by Foreign Corporation of Appointment of Agent to Accept Service of Process* (1914) 78 CENT. L. J. 364; Comment (1929) 77 U. OF PA. L. REV. 1010, 1013.

64. For lists of statutes see Culp, *Constitutional Problems Arising from Service of Process on Foreign Corporations* (1935) 19 MINN. L. REV. 375, 378-380.

65. New Eng. Mut. Life Ins. Co. v. Woodworth, 111 U. S. 138 (1884); Pa. Fire Ins. Co. v. Gold Issue Mining & Milling Co., 243 U. S. 93 (1917), noted in (1917) 26 YALE L. J. 794; RESTATEMENT § 91. But cf. Sawyer v. No. American Life Ins. Co., 46 Vt. 697 (1874). A minority of cases assume that the appointment is restricted to actions arising within the state in the absence of an express provision giving the appointment a broader scope. See Louisville & Nashville Rr. Co. v. Chatters, 279 U. S. 320, 329 (1928), noted in (1929) 38 YALE L. J. 1148; Morris & Co. v. Skandinavia Ins. Co., 279 U. S. 405, 409 (1929). If, however, the agent's authority to receive service were restricted to certain types of action, service upon him in an action to which his authority did not extend would seem to present the questions raised by the second situation, if he were a state official (see p. 1112, *infra*) or by the third, if he were an actual agent of the corporation (see p. 1113, *infra*).

to open the forum to the plaintiff despite such lack of consent, on the ground of the corporation's "implied consent" or its "presence" within the state or its "submission" to the jurisdiction of its courts, without at the same time subjecting the defendant to vexatiously imported litigation, has resulted in the drawing of illogical distinctions based largely on the place of origin of the cause of action. Thus, under statutes which provided that, in the event that a foreign corporation doing business in the state failed to designate a process agent, service on the Secretary of State should be deemed to be service on the corporation "for any legal cause of action," the Supreme Court twice refused to allow suits on causes of action which were not connected with any business done by the defendant in the state of forum.<sup>66</sup> The reasoning in both cases, however, is somewhat obscure.<sup>67</sup> They are possibly distinguishable on the ground that the particular statutes involved were defective in not requiring the respective state officials to give notice to the corporations, and that notice was not in fact given.<sup>68</sup> Nevertheless, the cases have been cited as establishing a general principle applicable to service upon a state official without express consent, and the Supreme Court and other courts have been careful to distinguish them in subsequent opinions. It is, therefore, an open question whether a statute of this type which expressly extended the state official's authority to receive service to foreign causes of action and required notification of the defendant would be constitutional.<sup>69</sup>

(3) Service on a state official under a statute of the latter type would seem to present the same problem as service, without the corporation's consent, on an actual agent of the corporation engaged in the conduct of its business within the state, for whichever theoretical basis of jurisdiction is adopted, whether "presence," "submission," or "implied consent," would apply to both cases and the only difference would be in the form of notification. The Supreme Court has, however, approved the assumption of jurisdiction in the latter case,<sup>70</sup> so

66. *Old Wayne Mut. Life Ins. Co. v. McDonough*, 204 U. S. 8 (1907); *Simon v. So. Ry. Co.*, 236 U. S. 115 (1914). .But cf. *Mass. Bonding & Ins. Co. v. Concrete Steel Bridge Co.*, 37 F. (2d) 695 (C. C. A. 4th, 1930).

67. Not until these two cases did the idea become current that there was any jurisdictional significance in the place where the contract was made or breached or the delict occurred, and much confusion is apparent in the cases as to what, if anything, the significance of these cases is.

68. Due process requires that notice be given when service is had under such statutes. *Consolidated Flour Mills Co. v. Muegge*, 278 U. S. 559 (1928), reversing with memorandum opinion 127 Okla. 295, 260 Pac. 745 (1927); cf. *Wuchter v. Pizzutti*, 276 U. S. 13 (1928), cited note 15, *supra*. But cf. *Washington ex rel. Bond & Goodwin & Tucker, Inc., v. Superior Ct.*, 289 U. S. 361 (1933), 89 A. L. R. 658 (1934), noted in (1933) 33 *Col. L. Rev.* 357, (1933) 18 *Iowa L. Rev.* 388, (1933) 81 *U. of Pa. L. Rev.* 469; followed in *Silva v. Cromlie & Co.*, 44 P. (2d) 719 (N. M. 1935), noted in (1935) 49 *Harv. L. Rev.* 339. See *Culp*, *supra* note 64, at 385-394.

69. Cf. *Owen v. Appalachian Power Co.*, 78 W. Va. 596, 89 S. E. 262 (1916).

70. Although service in such cases is now generally had with the aid of statutes, it may be had without statute. *Barrow Steamship Co. v. Kane*, 170 U. S. 100 (1898). Whether such service may be had where another agent has been expressly designated under statute seems to be a matter of construction of the statute. It was held exclusive in *Thompson v. Nat. Life Ins. Co.*, 28 F. (2d) 877 (W. D. Mo. 1928). But cf. *Green v. Equitable Mut.*

long as the agent on whom process is served is sufficiently representative in character that the law would imply, from his appointment and authority, the power to receive service of process,<sup>71</sup> even where the cause of action arose in another state.<sup>72</sup> The Court has never squarely decided a case commenced by service of this type where the cause of action not only arose in another state, but was totally unconnected in its origin with any business done by the corporation in the state of suit.<sup>73</sup> There is, however, no logical obstacle to such an extension of the Court's decisions, and the majority of the courts that have passed on this question have argued forcefully in favor of upholding judgments so obtained.<sup>74</sup>

*The Commerce Clause.* Complementing the formula of "lack of due process of law" as a restriction on this statutory extension of the plaintiff's choice of forums is the doctrine of "unreasonable burden on interstate commerce," first introduced by the Supreme Court in 1923 as a factor in the determination of the proper state of trial.<sup>75</sup> In that year, as a result of the notorious liberality of

Life & Endowment Ass'n, 105 Iowa 628, 75 N. W. 635 (1898); *Silver v. Western Assurance Co. of Toronto*, 3 App. Div. 572, 38 N. Y. Supp. 335 (1st Dep't, 1896).

71. *St. Louis S. W. Ry. Co. v. Alexander*, 227 U. S. 218 (1912).

72. *Baltimore & Ohio Rr. Co. v. Harris*, 12 Wall. 65 (U. S. 1870) (foreign origin not expressly noted); *N. Y., L. E. & W. Rr. Co. v. Estill*, 147 U. S. 591 (1893) (defendant's suggestion of foreign origin disregarded). *A fortiori* such service is sufficient where the cause of action arose within the state. RESTATEMENT § 92.

73. The question was expressly left open in *Davis v. Farmers' Cooperative Equity Co.*, 262 U. S. 312 (1923), cited note 76, *infra*.

74. *O'Brien v. So. Bell Teleph. & Teleg. Co.*, 292 Fed. 379 (S. D. Ala. 1923); *Tauza v. Susquehanna Coal Co.*, 220 N. Y. 259, 115 N. E. 915 (1917); *Johnston v. Atlantic Coast Line Rr. Co.*, 128 Misc. 82, 217 N. Y. Supp. 758 (Sup. Ct. 1926); *Stark v. Howe Sound Co.*, 141 Misc. 148, 252 N. Y. Supp. 233 (Sup. Ct. 1931); *Lipe v. Carolina, C. & O. Ry. Co.*, 123 S. C. 515, 116 S. E. 101 (1923), 30 A. L. R. 255 (1924); see YOUNG, FOREIGN CORPORATIONS AND OTHER CORPORATIONS (1912) 41-48. There are several such cases in the Supreme Court where it appears definitely that the action arose without the state, but only inferentially that it was not connected in its origin with business done in the state. *Dennick v. Central Rr. Co. of N. J.*, 103 U. S. 11 (1880); *In re Hohorst*, 150 U. S. 653 (1893); *Barrow Steamship Co. v. Kane*, 170 U. S. 100 (1898); *Mo. K. & T. Ry. Co. v. Reynolds*, 255 U. S. 565 (1921), *aff'g* in memorandum opinion *Reynolds v. Mo., K. & T. Ry. Co.*, 228 Mass. 584, 117 N. E. 913 (1917). *Contra*: *Fry v. Denver & R. G. Rr. Co.*, 226 Fed. 893 (N. D. Cal. 1915); *Takacs v. Phila. & R. Ry. Co.*, 228 Fed. 728 (S. D. N. Y. 1915); *cf. Farmers' & Merchants' Bank v. Fed. Res. Bank*, 286 Fed. 566, 589 (E. D. Ky. 1915); see 1 BEALE, *op. cit. supra* note 33, § 84.3; Fead, *supra* note 58; GOODRICH, CONFLICT OF LAWS (1927) § 78; Scott, *supra* note 13, at 579, n. 40; (1926) 60 AM. L. REV. 922; (1927) 61 *id.* 429.

75. It is not clear whether the interstate commerce clause is a limitation on the existence of jurisdiction over the subject matter or whether jurisdiction exists, but simply cannot be exercised in such a way as to burden interstate commerce. The latter would seem to be the better view, since the doctrine of undue burden on interstate commerce (see note 76, *infra*) is hardly so clearly identified with a national policy of permitting the free flow of interstate commerce that the defendant should not be allowed to waive the objection of its own inconvenience. See *Gloeser v. Dollar Steamship Lines*, 192 Minn. 376, 382, 256 N. W. 666, 669 (1934); *Foster, supra* note 4, 43 HARV. L. REV. at 1234; (1930) 43 HARV. L. REV. 1156. *Contra*: *Baltimore Mail Steamship Co. v. Fawcett*, 269 N. Y. 379, 199 N. E. 628 (1936).

Minnesota juries, there were pending in the courts of that state one thousand twenty-eight personal injury actions, involving claims of nearly twenty-six millions of dollars, by nonresident plaintiffs against foreign railroads with no trackage in the state. Under these conditions the Supreme Court of Minnesota, in the case of *Davis v. Farmers' Cooperative Equity Company*,<sup>76</sup> entertained an action by one Kansas corporation, which did no business in Minnesota, against another, a railroad which had no lines in Minnesota, on a cause of action arising wholly within Kansas, process having been served in Minnesota, under its statute,<sup>77</sup> upon the defendant's soliciting freight agent in the state. Although the Supreme Court might have disposed of the case simply by holding that there were insufficient activities to constitute "doing business" in the state,<sup>78</sup> the Court expressly left the due process question open and chose instead, in an opinion in which Mr. Justice Brandeis stressed the above statistics and the obvious inconvenience of trying such actions in forums distant from their place of origin, to base its reversal solely on the ground that such an action would unreasonably burden interstate commerce. The Supreme Court has since decided several cases developing the doctrine of the *Davis* case,<sup>79</sup> but they leave undetermined many questions as to when the orderly administration of local justice will justify the burden on interstate commerce incident to the trial of foreign causes of action.

There would appear from these cases, however, to be three principal variables which enter into a determination of this question. In the first place, the defendant railroad may or may not be operating in the state. This refers to the presence of trackage and is not to be confused with the due process requirement of "doing business," which may evidently be satisfied without the operation of lines in the state, and which applies only to actions *in personam*. A particular action, on the other hand, may come within the *Davis* doctrine, even though the defendant is not "doing business" in the state and the action is not *in personam*, but *quasi in rem*, as it was in several of the Supreme Court cases, where jurisdiction was obtained by the attachment of the defendant's rolling stock in the hands of a local road.<sup>80</sup> Secondly, the plaintiff may be a resident or nonresident, this factor being determined, in the case of a foreign corporation plaintiff, according to its "doing business" in the state of suit.<sup>81</sup> And, finally, the cause of action may be foreign or domestic in origin.<sup>82</sup>

76. 262 U. S. 312 (1923), hereafter referred to as the *Davis* case; see Comments (1933) 31 MICH. L. REV. 963; (1929) 13 MINN. L. REV. 485.

77. MINN. STAT. (Mason, 1927) § 9231.

78. Phila. & Reading Ry. Co. v. McKibbin, 243 U. S. 264 (1917); cf. Green v. Chicago, B. & Q. Ry. Co., 205 U. S. 530 (1907).

79. Cited notes 84, 85, 86, 89, 90, *infra*.

80. Atchison, T. & S. Ry. Co. v. Wells, 265 U. S. 101 (1924); Mo. ex. rel. St. Louis, B. & M. Ry. Co. v. Taylor, 266 U. S. 200 (1924); Denver & R. G. W. Rr. Co. v. Terte, 284 U. S. 284 (1932).

81. International Milling Co. v. Columbia Transp. Co., 292 U. S. 511, 519 (1934).

82. None of the cases distinguishes between foreign causes of action on the basis of whether or not they are connected in their origin with business done by the defendant within the state.

These three factors, it has been observed,<sup>83</sup> create eight distinct possibilities:

	Is plaintiff resident?	Is defendant operating in the state?	Is cause of action domestic?
1	No	Yes	No
2	No	Yes	Yes
3	No	No	No
4	No	No	Yes
5	Yes	Yes	No
6	Yes	Yes	Yes
7	Yes	No	No
8	Yes	No	Yes

Only the third, fifth, and eighth situations have been passed upon by the Supreme Court: the third was held to present an unreasonable burden in the *Davis* case and others,<sup>84</sup> while actions of the fifth<sup>85</sup> and eighth<sup>86</sup> types were sustained. But most of the courts that have passed on the first type have also sustained the exercise of jurisdiction there.<sup>87</sup> By analogy to these three types the second and sixth types would seem *a fortiori* to present no unreasonable burden. The fourth and seventh situations are doubtful.<sup>88</sup>

83. See Farrier, *Suits Against Foreign Corporations as a Burden on Interstate Commerce* (1933) 17 MINN. L. REV. 381; Dainow, *The Inappropriate Forum* (1935) 29 ILL. L. REV. 867.

84. *Atchison, T. & S. Ry. Co. v. Wells*, 265 U. S. 101 (1924); *Mich. Cent. Rr. Co. v. Mix*, 278 U. S. 492 (1929); *Denver & R. G. W. Rr. Co. v. Terte*, 284 U. S. 284 (1932), last two cases cited note 89, *infra*. *Contra*: *N. V. Brood en Beschuitfabriek v. Aluminum Co. of Amer.*, 136 Misc. 349, 239 N. Y. Supp. 702 (N. Y. City Ct. 1930).

85. *International Milling Co. v. Columbia Transportation Co.*, 292 U. S. 511 (1934), noted in (1934) 34 COL. L. REV. 1135; *Amer. Ry. Exp. Co. v. Rouw Co.*, 173 Ark. 810, 294 S. W. 401 (1927); *Cohen v. Del., L. & W. Rr. Co.*, 150 Misc. 450, 269 N. Y. Supp. 667 (Sup. Ct. 1934); *Denver & R. G. W. Rr. Co. v. Terte*, 284 U. S. 284 (1932), cited note 89, *infra*, *semble*.

86. *Mo. ex rel. St. Louis, B. & M. Ry. Co. v. Taylor*, 266 U. S. 200 (1924); *Perc Marquette Ry. Co. v. Tifton Produce Co.*, 48 Ga. App. 286, 172 S. E. 727 (1934).

87. *O'Brien v. So. Bell Teleph. & Teleg. Co.*, 292 Fed. 379 (S. D. Ala. 1923); *Harris v. Amer. Ry. Exp. Co.*, 12 F. (2d) 487 (App. D. C. 1926); *McWhorter v. Williams*, 155 So. 309 (Ala. 1934); *Boright v. Chicago, R. I. & P. Rr. Co.*, 180 Minn. 52, 230 N. W. 457 (1930); *Murnan v. Wabash Ry. Co.*, 220 App. Div. 218, 221 N. Y. Supp. 332 (2d Dep't, 1927) *rev'd* on another point, 246 N. Y. 244, 158 N. E. 508 (1927); *Denver & R. G. W. Rr. Co. v. Terte*, 284 U. S. 284 (1932) cited note 89, *infra*, *semble*. *Contra*: *Weinard v. Chicago, M. & S. Ry. Co.*, 298 Fed. 977 (D. Minn. 1924); *Pantswowe Zaklady Gravitiozne v. Automobile Ins. Co.*, 36 F. (2d) 504 (S. D. N. Y. 1928), noted in (1930) 43 HARV. L. REV. 1156; *Iron City Produce Co. v. Amer. Ry. Co.*, 22 Ohio App. 165, 153 N. E. 316 (1926). The last two cases simply followed the *Davis* case, overlooking the factual distinction of operation.

88. No case has been found of the fourth type, a difficult situation to imagine. The plaintiff's residence alone, however, should not be the determining factor. See *International Milling Co. v. Columbia Transp. Co.*, 292 U. S. 511, 519 (1934). It would therefore seem that the fourth situation should present no unreasonable burden, by analogy to the eighth. And similarly, the seventh situation would seem to be otherwise, by analogy to the third.

This scheme, however, is of questionable value as indicative of future holdings, for it is based on a consideration of only the ultimate factors. It ignores the many evidentiary facts which distinguish every case and which, in the doubtful types of cases particularly, may influence the decision as to the appropriateness of the local forum in favor of one party or the other.<sup>89</sup> But it does illustrate that the courts have been loath to extend the *Davis* doctrine beyond the extreme facts of that case or, at the most, the seventh situation, where the factors are the same except that the plaintiff is a resident of the state of suit. Beyond these eight situations, all involving actions against foreign railroad corporations, the applicability of the commerce formula is doubtful. In the only case involving a domestic railroad in which the argument was advanced before the Supreme Court, the doctrine of the *Davis* case was held inapplicable, but, although the plaintiff in that case was a nonresident and the cause of action foreign, the defendant was operating in the state.<sup>90</sup> Nevertheless, the *Davis* case presents the possibility of using the commerce clause, as an additional adjuster of the state of trial for the defendant's protection, when the necessity is felt for further restriction than is available under the due process clause, not only in actions against domestic railroad corporations not operating within the state as well as foreign railroad companies, but also in actions against non-carrier corporations and non-corporation defendants.<sup>91</sup>

[To be continued]

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But the few cases of the seventh type are in conflict. In accord: *Baltimore Mail Steamship Co. v. Fawcett*, 269 N. Y. 379, 199 N. E. 628 (1936); *Miele v. Chicago, M., S. & P. Rr. Co.*, 151 Misc. 137, 270 N. Y. Supp. 788 (N. Y. City Ct. 1934); *Denver & R. G. W. Rr. Co. v. Terte*, 284 U. S. 284 (1932) *semble*. *Contra*: *Griffin v. Seaboard Air Line Ry. Co.*, 28 F. (2d) 998 (W. D. Mo. 1928), noted in (1929) 17 CALIF. L. REV. 396; *Cressey v. Erie Rr. Co.*, 278 Mass. 284, 180 N. E. 160 (1932).

89. Nor does it consider the factor of the plaintiff's change of residence between the time of accrual of the cause of action and the time of suit. If the plaintiff's moving to the state of suit is solely for the purpose of bringing his action, he will be deemed still a nonresident. *Mich. Cent. Rr. Co. v. Mix*, 278 U. S. 492 (1929). And this seems to be so even where he "became a bona fide resident and citizen" of the state of suit. *Denver & R. G. W. Rr. Co. v. Terte*, 284 U. S. 284, 286 (1932), noted in (1932) 32 COL. L. REV. 541.

90. *Hoffman v. Mo. ex rel. Foraker*, 274 U. S. 21 (1927).

91. Authority thus far is too meager to admit of any prediction. The *Davis* case and the other three Supreme Court cases, cited note 84, *supra*, in which there was an affirmative holding on the question of undue burden were all actions against railroad corporations. See *Baltimore Mail Steamship Co. v. Fawcett*, 269 N. Y. 379, 199 N. E. 628 (1936) (steamship co.); *Iron City Produce Co. v. Amer. Ry. Exp. Co.*, 22 Ohio App. 165, 153 N. E. 316 (1926) (express Co.). There is a suggestion in *Hoffman v. Mo. ex rel. Foraker*, 274 U. S. 21, 23 (1927), that the commerce doctrine may be extended beyond carriers, though it may perhaps be limited to corporations. But cf. *Steele v. Western Union Teleg. Co.*, 206 N. C. 220, 173 S. E. 583 (1934); *Winslow Lumber Co. v. Hines Lumber Co.*, 125 Ore. 63, 266 Pac. 248 (1928), noted in (1928) 42 HARV. L. REV. 131.